85-558

No. ____

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

ROBERT E. O'CONNOR and GLADYS E. O'CONNOR,
Petitioners,

v.

UNITED STATES OF AMERICA,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

ALLAN I. MENDELSOHN
MARVIN L. SZYMKOWICZ
WARD & MENDELSOHN, P.C.
1100 - 17th Street, N.W.
Suite 900
Washington, D.C. 20036
(202) 785-0200
Counsel for Petitioners

OF COUNSEL:
DWIGHT A. MCKABNEY
Apartado 3116
Balboa-Ancon
Republic of Panama

PRESS OF BYRON S. ADAMS, WASHINGTON, D.C. (202) 347-8203

19 pp

QUESTIONS PRESENTED

1. Whether a provision of the Agreement in Implementation of the 1977 Panama Canal Treaty exempts United States citizen employees of the Panama Canal Commission from taxation by both the United States and Panama on their Commission income. This provision reads as follows:

> United States citizen employees and dependents shall be exempt from any taxes, fees, or other charges on income received as a result of their work for the Commission. Similarly, they shall be exempt from payment of taxes, fees or other charges on income derived from sources outside the Republic of Panama.

2. Whether diplomatic correspondence may be introduced by the Government immediately before oral argument in the court of appeals where the Government itself is a litigant and where it repeatedly refused the trial court's urgings to obtain and introduce such matters below.

Note: The case caption contains the names of all the parties.

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UNITED STATES OF AMERICA,

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

Petitioners Robert E. O'Connor and Gladys E. O'Connor pray that a Writ of Certiorari issue to review the opinion and judgment of the United States Court of Appeals for the Federal Circuit entered on May 10 and July 3, 1985, respectively.

OPINIONS BELOW

The opinion of the Court of Appeals is reported at 761 F.2d 688. That opinion reversed the judgment and opinion of the United States Claims Court (Chief Judge Kozinski presiding) which is reported at 6 Cl.Ct. 115.

JURISDICTION

The opinion of the Court of Appeals for the Federal Circuit was entered on May 10, 1985. A timely petition for rehearing was denied on July 3, 1985. This petition for a writ of certiorari was filed within 90 days of that date. This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1).

TREATY AND STATUTORY PROVISIONS INVOLVED

Panama Canal Treaty between the United States of America and Panama, September 7, 1977, T.I.A.S. No. 10030:

Article III

Canal Operation and Management

* * * * *

9. The use of the areas, waters and installations with respect to which the United States of America is granted rights pursuant to this Article and the rights and legal status of the United States Government agencies and employees operating in the Republic of Panama pursuant to this Article, shall be governed by the Agreement in Implementation of this Article signed this date.

* * * * *

Agreement between the United States of America and Panama In Implementation of Article III of the Panama Canal Treaty, September 7, 1977, T.I.A.S. No. 10031:

Article XV

Taxation

* * * * *

2. United States citizen employees and dependents shall be exempt from any taxes, fees, or other charges

on income received as a result of their work for the Commission. Similarly, they shall be exempt from payment of taxes, fees, or other charges on income derived from sources outside the Republic of Panama.

* * * * *

United States Code Title 26, Section 894(a):

(a) Income exempt under treaty. - Income of any kind, to the extent required by any treaty obligation of the United States, shall not be included in gross income and shall be exempt from taxation under this subtitle.

STATEMENT OF THE CASE[1]

The 1977 Panama Canal Treaty was the culmination of negotiations that had commenced in 1964. Senate Hearings on Panama Canal Treaty Before the Committee on Foreign Relations, 95th Cong., 1st Sess. (1977) at 50-51 (hereafter referred to as "Hearings"). The Treaty provides that Panama will enjoy increasing territorial sovereignty over the Canal and that its sovereignty will become exclusive on December 31, 1999. Until then, the Canal is to be governed by the Panama Canal Commission. 761 F.2d at 689-90. Although denominated in the Treaty as an agency of the United States, four of the Commission's nine board members are Panamanian citizens, nominated by the Government of Panama. Treaty, Article III(3)-(10) and Article X(3).

Whether and how United States citizen employees of the Commission would be taxed was one of the last Treaty provisions to be agreed upon. As of June 24, 1977, all Treaty questions with the exception of "economic arrangements"

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[1]Most record references will be to the two-volume record appendix used on appeal. The volumes will be designated as "I" and "II".

had been settled. R.II, 163. Taxation of United States citizen employees of the Commission was part of these "economic arrangements". *Id.*

Negotiations on the taxation issue were s[illegible]ed and, at times, acrimonious. Both the United States and Panama claimed a right to tax the U.S. citizen employees. R.I, 89. Panama viewed that right as an essential attribute of its impending sovereignty. R.I, 120-21. The chief U.S. negotiator, Ambassador Sol Linowitz, remonstrated that Panamanian taxation would mean a loss of revenue to the United States Treasury. R.I, 116-17. Internally, however, the U.S. negotiating team feared that permitting a foreign government to tax foreign-based U.S. citizen employees of a U.S. agency would set a "bad precedent".[2] R., 164.

The taxation impasse was finally resolved in negotiations held during mid-July and early August 1977. The Department of State has represented that there is a gap in the negotiating history: no contemporaneous record of any negotiating session is available after July 18, 1977. 6 Cl.Ct. at 131. Accordingly, the manner in which the impasse was resolved cannot be precisely determined. Nevertheless,

[2]Secretary Vance's confidential memorandum to the Policy Review Committee, dated July 19, 1977, expresses this concern:

> Panama has proposed that effective three years after entry into force of the treaty the United States citizens employed by the Canal Administration pay income taxes to Panama. They estimate these taxes at $7-10 million a year.
>
> The United States *could* acquiesce to Panamanian taxation of its U.S. employees. However, United States Government employees are exempted from host country income taxes throughout the world. Making Panama an exception would set a bad precedent for U.S. Government operations in other foreign countries. Secondly, we estimate that revenue generated from such taxation would amount to not more than $3 million per year.

when the negotiations ended in August 1977, the present language of Article XV(2), exempting Commission salaries from "any" taxes, had somehow managed to reconcile the conflict of views.

Following its adoption, Article XV(2)'s exemption language attracted attention from officials throughout the U.S. Government. Attorneys in the Treasury Department, appreciating that the language created an apparent reciprocal tax exemption, recommended a clarification. R.I, 58-59. The recommendation was not acted upon. During hearings on the Treaty before the Senate Foreign Relations Committee, Senator Stone also recommended a clarification. His recommendation was based on published press reports that U.S. residents of the then Canal Zone expressed "glee" on learning that Article XV(2) created a reciprocal tax exemption. Senator Stone's recommendation was not acted upon. Hearings at 268-69.

When this proceeding was before the Claims Court, Judge Kozinski urged the U.S. Government to seek some clarification from Panama on the meaning of the provision. That request, too, was not acted upon.[3]

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[3]A portion of the Court's colloquy with Government counsel is reprinted below (Transcript of March 8, 1984 at pp. 43-47):

> Court: I am giving you the opportunity to obtain from Panama their understanding as to the meaning of this provision. That is what I gave your attorney two weeks ago. It is done all the time for one Government to get a diplomatic note from another Government saying we had a Treaty provision and this is what it means. If you don't want to get it, I will draw whatever inferences can be drawn from the refusal to obtain that.
>
> Mr. Peyser: I think the case should be decided on the materials before the Court.
>
> Court: So I am going to ask you one more time, Mr. Peyser, do

Differences concerning the interpretation of Article XV(2) exist even between the treaty negotiators of the two nations. An affidavit by Dr. Carlos Alfredo Lopez Guevara, Ambassador Extraordinary and Plenipotentiary, one of the principal Panamanian negotiators who was present at the negotiating table when the provision was finally adopted, was presented in the trial court. R.II, 192-93. Ambassador Lopez Guevara stated that the language of Paragraph XV(2) was intended to preclude both the United States and Panama from taxing Americans and that it was so understood by Panama.[4] The United States' explanation, ad-

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you wish to take advantage of the opportunity to supplement the record by obtaining a clarification of Panama's understanding of the Treaty language? If you wish, have a few days or a week to go back and check on that. I will give it to you, but I want a concise and clear yes or no answer from the United States.

Mr. Peyser: No. No, your Honor.

* * *

Mr. Peyser: I don't [think] the opinion of any official in Panama in 1984 is persuasive.

Court: . . . All I can gather is that you don't think you are going to get from Panama the interpretation that you want.

Mr. Peyser: I have no idea what the response would be from Panama.

Court: Well, would you like to go find out?

Mr. Peyser: I decline the invitation to do that. I understand you are asking if we would like to do that, and the answer is, no. I don't think it would be appropriate or necessary.

[4]Similar views were incorporated in sworn statements from Juan Antonio Tack, Minister of Foreign Relations (and head of the Panamanian negotiating staff between 1970 and 1976) and from Demetrio B. Lakas, Panama's then President. R.II, 183-91.

vanced by the State Department's now Deputy Legal Advisor Michael Kozak,[5] was that the Panamanian government simply acceded to the U.S. view that it alone could impose taxes on citizen employees of the Commission. R.I, 89-90.

The O'Connors brought suit in the U.S. Claims Court for refund of taxes paid with respect to income earned by Mr. O'Connor, as a Commission employee, during the year 1981. The basis for their refund claim was the language of Article XV(2). Judge Kozinski granted summary judgment in the O'Connor's favor in the amount of $7,959.00, representing the federal income taxes paid by the O'Connors on the 1981 Commission salary. The United States appealed to the United States Court of Appeals for the Federal Circuit, where the appeal was consolidated with *Coplin*. 761 F.2d at 689. There are over 200 other similarly situated taxpayer suits pending in the Claims Court. All these actions await this Court's disposition of this petition.

Oral argument was held below on Monday, March 4, 1985. On February 28, 1985, however, the U.S. Government, as part of its Reply Brief, informed the Court that on February 25, 1985 the United States received diplomatic correspondence from the Panamanian Foreign Minister indicating that, on the basis of an inquiry he had made of three of Panama's treaty negotiators, the Foreign Ministry shared the United States view that Article XV(2) was not a reciprocal exemption. Petitioners moved to strike the correspondence from the record.[6]

[5]Mr. Kozak was a member of the U.S. team negotiating the treaty, but was "not present at any negotiating session during which the substance of Article XV was discussed". *Harris* v. *United States*, 760 F.2d at 1246, 1247.

[6]The basis of the motion to strike was that petitioners had not had an opportunity to inquire into the provenance of the diplomatic correspondence or to challenge its validity in light of the contrary view expressed in 1984 by the then Foreign Minister of Panama.

On May 10, 1985, the Federal Circuit denied petitioners' motions to strike and reversed Judge Kozinski's decision. Writing for the five-member panel, Judge Bissell found that:

> "[T]he record now reveals the intent of each government. Since both treaty parties agree that paragraph 2 was not intended to create an exemption from United States domestic taxation, the trial court's decision cannot be upheld."

761 F.2d at 692. Judge Bissell ruled that, notwithstanding the circumstances, the Court was permitted to consider the diplomatic correspondence because of the Court's powers to take judicial notice of "'the public acts and proclamations of (foreign) governments'". 761 F.2d at 691. In a concurring opinion, in which Judges Rich and Baldwin joined, Judge Nies concluded that she did not find it necessary to consider the diplomatic note. "A complete reading of the record, the treaty and the Implementation Agreement leads me to conclude that Article XV had no relevance to taxation by the United States of its own citizens". 761 F.2d at 692.

REASONS FOR GRANTING THE WRIT

I. THE DECISION BELOW DIRECTLY CONFLICTS WITH THE DECISION OF THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT AS TO THE PROPER INTERPRETATION OF THE PANAMA CANAL TREATY AND ARTICLE XV(2) OF ITS IMPLEMENTATION AGREEMENT

The United States Court of Appeals for the Eleventh Circuit, on August 14, 1985, rendered a decision in *Harris* v. *United States*, 768 F.2d 1240 (1985) on issues identical to those presented below. As in *Coplin*, the plaintiffs were U.S. citizen Commission employees who, on the strength of Article XV(2), sought refunds of federal taxes paid on their Commission salaries. As in *Coplin*, the trial court entered

judgment for the taxpayers, holding that the language of Article XV(2) was "unmistakably clear". 585 F.Supp. 863. The decisions conflict on two material questions of law.

1. The Federal Circuit's decision in *Coplin* directly conflicts with *Harris* on the central question of the interpretation of Article XV(2). Judge Nies's concurring opinion (representing the views of a majority of the Court) concluded that, based on the Claims Court record alone, Article XV(2) should be judicially re-titled as "Taxation by the Republic of Panama", rather than "Taxation" *simpliciter*.

By contrast, the Eleventh Circuit found the clear meaning of Article XV(2)'s use of the term "taxation" to be taxation by both Panama and the United States. It reached its conclusion based on the following considerations:

(a) the "clear and sweeping terms" of Article XV(2);

(b) the contrast between the inclusive language of Article XV(2) and several other provisions of the Treaty package where taxing powers were expressly accorded or limited to one nation or the other;

(c) the fact that the United States was represented by a "distinguished negotiating team", rendering it highly unlikely that "inadvertence or oversight" caused a drafting error;

(d) the affidavits of Dr. Lopez Guevara and other officials involved on the Panamanian side of the negotiations (properly introduced in the district court) that indicated that Article XV(2) was intended to be a reciprocal tax exemption and was so interpreted by Panama;

(e) the U.S. Government's failures to clarify Article XV(2), despite repeated requests and opportunities to do so;

(f) the fact that American citizens employed in connection with Canal operations have historically enjoyed monetary incentives;

(g) the fact that potential tax revenues lost to the U.S. through a reciprocal exemption "may be considered slight" compared to the significant economic concessions made to Panama in the Treaty package, and that the number of Americans who will benefit by such an exemption will decline progressively until December 31, 1999, when U.S. participation in the Canal will be phased out entirely.[7]

Petitioners submit that when two Circuits interpreting the same treaty language find two different and totally contrary clear meanings, certiorari should be granted to resolve the conflict.

2. As in *Coplin*, the United States provided the diplomatic correspondence to the *Harris* court shortly before oral argument. Unlike the Federal Circuit, however, the Eleventh Circuit declined to consider it. The Court found no reason to relax the prohibition limiting its appellate consideration to matters that were in the trial record. 768 F.2d at 1243 *et seq.*

3. In addition to the general desireability of resolving Circuit conflicts, petitioners submit that uniformity of decision among the circuits is particularly necessary in the law of treaties and international executive agreements. This petition should be granted in order to establish a single United States position on a treaty controversy affecting *both* Commission employees and the interests of the Republic of Panama.

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[7]In *Harris*, as in *Coplin*, the Government relied upon some ten earlier lower court decisions to support its view of Article XV(2). *Harris* discounted these earlier holdings (none of which was appealed), observing that they were all reached before Judge Kozinski required the State Department to declassify all non-confidential Treaty negotiating history and before the views of Ambassador Lopez Guevara and his colleagues became available.

II. THE DECISION BELOW RAISES SIGNIFICANT AND POTENTIALLY RECURRING PROBLEMS CONCERNING EVIDENTIARY MATTERS THAT FEDERAL COURTS MAY PROPERLY CONSIDER IN CONSTRUING TREATIES

Since the end of World War II, there has been a marked increase in the number of treaties and executive agreements to which the United States is a party. Many of these, as here, relate to private rights, in contrast to public international law. The result has been substantial increased litigation. The *Harris* case and the earlier suits on the same issue are but a few examples. A "Westlaw" search conducted in connection with this Petition indicates that during the decade from 1970 through 1979, there were 195 reported federal court decisions in which the term "treaty" appeared within five words of some variant of the term "interpret" or "construe". The same search conducted only for the period January 1, 1980 to date discloses the same combination of terms in 218 cases.

The conflict between *Harris* and *Coplin* reflects deep judicial uncertainty over the proper rules of evidence and procedure applicable to treaty interpretation. One of these questions is whether *Sumitomo Shoji America, Inc.* v. *Avagliano*, 457 U.S. 176 (1982) — where the Executive Branch was allowed to introduce a Japanese Government diplomatic note at the appellate level — must be followed in all circumstances. The government relied on *Sumitomo* in both *Harris* and *Coplin* in urging that the extra-record correspondence be considered. *Harris* and *Coplin* adopted diametrically opposed positions on the issue. In *Harris*, the Eleventh Circuit ruled that the Panamanian diplomatic correspondence was subject to the usual rule excluding extra-record evidence from appellate consideration. It characterized the correspondence "as self-serving evidence outside the record, for which additional explanation is re-

quired". *Harris* at 1242. In contrast, *Coplin* ruled that the diplomatic correspondence was a fact capable of judicial notice at *any* time.

Subsumed within this conflict, moreover, are critical differences over several established rules of evidence that normally would have entitled the taxpayers below: (a) to test the competency of the three almost identical letters solicited by and relied upon by the Panamanian Foreign Minister in the diplomatic correspondence; (b) to challenge the manner in which and the reasons why the correspondence was obtained by the U.S. Government only on the eve of appellate oral argument; and (c) to inquire why the U.S. Government did not disclose to the *Coplin* or *Harris* courts that, in July 1984, Panamanian authorities appeared to take a position on the tax issue different than that advanced in the diplomatic correspondence. Petitioners believe that the Federal Circuit's approach below deprived them of established evidentiary rights and protections.

A final question is whether *Sumitomo* should apply where, as here, the United States is a party to the litigation. *Sumitomo* was private party litigation in which the United States appeared as *amicus curiae* to present the views of the Department of State and the Government of Japan. It did not have a financial stake in the outcome of the litigation.

We respectfully suggest that these are important and potentially recurring issues that are worthy of briefing and reasoned consideration by this Court.

III. THE PRACTICAL CONSEQUENCES OF THE FOREGOING CONFLICT OF THE CIRCUITS WILL BE THE DIFFERENTIAL OPERATION OF THE FEDERAL TAX COLLECTION SYSTEM

A failure definitively to resolve the conflict in interpretation of Article XV(2) will have substantial adverse consequences on the federal tax collection system including:

(a) U.S. citizen Commission employees domiciled in the three states comprising the Eleventh Circuit (i.e. Florida, Georgia and Alabama) will be exempt from taxes that citizen Commission employees domiciled in other states will be required to pay;

(b) U.S. citizen Commission employees who filed refund suits in the Claims Court will be denied refunds that will be granted to citizen employees who filed, or will file, their suits in the Eleventh Circuit.

(c) hundreds, if not thousands, of U.S. citizen Commission employees who presently reside in Panama or somewhere in the U.S. outside the Eleventh Circuit will exercise their constitutional right to change their residence and to domicile themselves in one of the states of the Eleventh Circuit in order to benefit from the *Harris* ruling.[8]

Apart from their inherent harm, these consequences, and their attendant publicity, will further erode public confidence in the federal income tax system.

---

[8]When the Treaty entered into force in October 1979, there were approximately 3,300 U.S. citizen employees of the then Panama Canal Zone. Today, there are approximately 1,400 citizen employees of the Commission. The total payroll for these individuals during the period October 1, 1979 to date is approximately $400 million.

CONCLUSION

For the foregoing reasons, it is respectfully submitted that this petition for a writ of certiorari should be granted.

ALLAN I. MENDELSOHN
MARVIN L. SZYMKOWICZ
WARD & MENDELSOHN, P.C.
1100 - 17th Street, N.W.
Suite 900
Washington, D.C. 20036
(202) 785-0200
Counsel for Petitioners

OF COUNSEL:
DWIGHT A. MCKABNEY
Apartado 3166
Balboa-Ancon
Republic of Panama

85-558 Nos. 85-559 85-560

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v.

UNITED STATES OF AMERICA,
Respondent.

PAUL H. and PATRICIA COPLIN,
Petitioners

v.

UNITED STATES OF AMERICA,
Respondent.

JACK R. and MARIA R. MATTOX,
Petitioners,

v.

UNITED STATES OF AMERICA,
Respondent.

PETITIONS FOR WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

PETITIONERS' APPENDIX

ANDREW C. BARNARD
BARNARD, P.A.
9769 South Dixie Highway
Suite 201
Miami Florida 33156
(305) 665-0000

Counsel for Petitioners Coplin

ALLAN I. MENDELSOHN
MARVIN L. SZYMKOWICZ
WARD & MENDELSOHN, P.C.
1100 17th Street, N.W.
Suite 900
Washington, D.C. 20036
(202) 785-0200
Counsel for Petitioners O'Connor

JOHN C. MORRISON
KIEFFER & MORRISON
200 North Fairfax Street
Alexandria, Virginia 22314
(703) 549-8844
Counsel for Petitioners Mattox

PRESS OF BYRON S. ADAMS, WASHINGTON, D.C. (202) 347-8203

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APPENDIX A

UNITED STATES COURT OF APPEALS,
FEDERAL CIRCUIT.

MAY 10, 1985.

Appeal Nos. 85-504 to 85-507.

PAUL H. AND PATRICIA COPLIN,

Appellees,

v.

THE UNITED STATES,

Appellant.

ROBERT E. O'CONNOR, *et ux.*, GLADYS E. O'CONNOR,

Appellees,

v.

THE UNITED STATES,

Appellant.

JON D. COFFIN,

Appellee,

v.

THE UNITED STATES,

Appellant.

JACK R. AND MARIA R. MATTOX,

Appellees,

v.

THE UNITED STATES,

Appellant.

Taxpayers employed by the Panama Canal Commission filed suits for refund of federal income taxes. The Claims Court,

Alex Kozinski, Chief Judge, 6 Cl.Ct. 115, held that United States citizens employed by the Panama Canal Commission are exempt from United States income tax. Government appealed. The Court of Appeals, Bissell, Circuit Judge, held that the taxpayers were not exempt from United States domestic taxation in that the Panama Canal Treaty only exempted income earned by United States citizens from taxation by Panama.

Reversed.

Bissell, Circuit Judge, filed an opinion stating additional views in which Edward S. Smith, Circuit Judge, joined.

Nies, Circuit Judge, with whom Rich and Baldwin, Circuit Judges, joined, concurred with opinion.

Before RICH, BALDWIN, SMITH, NIES and BISSELL, Circuit Judges.

BISSELL, Circuit Judge.

The government appeals from a decision of the United States Claims Court holding that United States citizens employed by the Panama Canal Commission are exempt from United States income tax. We reverse.

BACKGROUND

These appeals were consolidated by order of this court dated October 22, 1984, and involve suits for the refund of federal income taxes. Paul Coplin, Robert O'Connor, Jon Coffin, and Jack Mattox are United States citizens and during the respective relevant tax years were employees of the Panama Canal Commission (Commission), an agency of the United States government. The wages they received from the Commission were included in computing their federal income tax for the years 1979 (Coplin and Coffin), 1980 (Mattox), and 1981 (O'Connor and Mattox). Based on their understanding of an international agreement, the taxpayers filed claims for refund for the amount of tax paid with respect to income received from the Commission. The Internal Revenue Service denied each of their claims and these suits followed.

On September 7, 1977, after years of negotiation, the United States and the Republic of Panama signed the Panama Canal Treaty, T.I.A.S. No. 10030. The Senate approved the treaty and it entered into force on October 1, 1979, restoring to Panama territorial sovereignty over the Canal Zone. Panama granted to the United States the right to manage, operate, and maintain the canal until the year 2000. During this period the canal is to be operated by the Commission. The treaty provides for increasing participation by the Republic of Panama in the management of the canal, in preparation for its assumption of full responsibility for the canal's operation when the treaty expires.

Because the Canal Zone would no longer be subject to United States territorial sovereignty, it was necessary to define the rights and legal status of the Commission and its employees vis-a-vis each country. These matters were to be governed by the Agreement Implementing Article III of the Panama Canal Treaty, Sept. 7, 1977, United States-Panama, T.I.A.S. No. 10031 (Implementation Agreement). The Implementation Agreement contains twenty-one articles governing such subjects as registration of vehicles, exemption from import duties, and criminal jurisdiction. Article XV thereof deals with taxation of the Commission and its United States citizen employees:

ARTICLE XV

TAXATION

1. By virtue of this Agreement, the Commission, its contractors and subcontractors are exempt from payment in the Republic of Panama of all taxes, fees or other charges on their activities or property.

2. United States citizen employees and dependents shall be exempt from any taxes, fees, or other charges on income received as a result of their work for the Commission. Similarly, they shall be exempt from payment of

taxes, fees or other charges on income derived from sources outside the Republic of Panama.

3. United States citizen employees and dependents shall be exempt from taxes, fees or other charges on gifts or inheritance or on personal property, the presence of which within the territory of the Republic of Panama is due solely to the stay therein of such persons on account of their or their sponsor's work with the Commission.

4. The Coordinating Committee may establish such regulations as may be appropriate for the implementation of this Article.

The dispute centers on the correct interpretation of the first sentence in paragraph two. The taxpayers claimed that, according to a literal interpretation, income earned by all United States citizens from the Commission was exempt from United States income taxation. The government contended that the provision was intended to bar only Panama, and not the United States, from taxing Commission employees. The court entered an order stating that all parties would be bound by relevant rulings in the Coplins' case. On cross-motions for summary judgment the Claims Court granted the Coplins' motion and denied the government's motion. *Coplin v. United States*, 6 Cl.Ct. 115 (1984). On the basis of Coplin, the court entered judgment for the taxpayers in all four cases on July 31, 1984.

OPINION

This court has jurisdiction pursuant to 28 U.S.C. § 1295(a)(3). In reviewing a grant of summary judgment we determine whether there is no genuine issue of material fact and whether the movant is entitled to judgment as a matter of law. *D.M.I., Inc. v. Deere & Co.*, 755 F.2d 1570, 1573 (Fed.Cir.1985).

In the Claims Court the government argued that the treaty language should not be construed literally because to do so would do violence to the intention of the signatories. The court recognized that it should not give literal effect to treaty lan-

guage if it was persuaded that such language did not reflect the intention of the parties. *Coplin*, 6 Cl.Ct. at 127. The court observed that "the record is devoid of any statement of the official Panamanian position." *Id.* at 146. Despite government arguments that the literal language did not reflect the intention of the United States, the court construed the language literally because the government presented "*no evidence whatsoever* as to the interpretation given this language by Panama." *Id.* at 128, 145-47, 149 (emphasis in original).

On the morning of March 4, 1985, the day we heard oral argument in this case, the government's reply brief was delivered to the chambers of the panel members. In that brief the government informed the court that "[o]n February 25, 1985, the United States received a diplomatic note from the Panamanian Foreign Minister in which he confirmed that the Panamanian Foreign Ministry shared the United States' view that the Implementing Agreement was not intended to affect United States taxation of Commission employees." Reply Br. at 6. The Foreign Minister enclosed letters from the Panamanian team that negotiated the Implementation Agreement. In those letters the Panamanian negotiators confirmed that Paragraph 2 of Article XV was "discussed, negotiated and drafted exclusively with respect to the tax exemption that the Republic of Panama would grant to United States-citizen employees of the Commission and their dependents" and that the "provisions resulted from negotiations that did not deal with the United States[']authority to tax the individuals mentioned therein." *Id.* In an appendix to the brief the government included the cable from the United States embassy in Panama transmitting the diplomatic note and the accompanying letters to the State Department.

I. Motions to Strike

Later that morning the appellees filed motions to strike all of the documents in the appendix to the reply brief as well as all references to them in the text of the reply brief.

The general rule on supplementing the record with new evidence is that "appellate courts . . . can act on no evidence

which was not before the court below, nor receive any paper that was not used at the hearing." *Boone v. Chiles*, 35 U.S. (10 Pet.) 177, 208, 9 L.Ed. 388 (1836); *cf. United States v. Miller*, 80 U.S. (13 Wall.) 568, 576, 577, 20 L.Ed. 705 (1872) (evidence cannot be received in Supreme Court to contradict a finding of Court of Claims).

Nevertheless, the Supreme Court has recognized a long established exception when construing the meaning of treaties. Reversing the judgment of a lower court on the question whether the validity of a grant of land was protected by certain treaties, the Supreme Court examined diplomatic records outside the record and held that "the public acts and proclamations of (foreign) governments, and those of their publicly recognized agents, in carrying into effect those treaties, though not made exhibits in this cause, are historical and notorious facts, of which the court can take regular judicial notice." *United States v. Reynes*, 50 U.S. (9 How.) 127, 147-48, 13 L.Ed. 74 (1850); *see generally Jones v. United States*, 137 U.S. 202, 214-16, 11 S.Ct. 80, 84-85, 34 L.Ed. 691 (1890). In construing an extradition treaty the Court directed counsel's attention to matter outside the record and invited counsel to conduct a further search through "available diplomatic records and correspondence" in preparation for reargument of the case. *Factor v. Laubenheimer*, 290 U.S. 276, 295, 54 S.Ct. 191, 196, 78 L.Ed. 315 (1933). Nor is our consideration of the cable barred because it was not "available" when the record closed in the lower court. In determining the proper interpretation of a treaty provision, the Supreme Court relied on expressions of intent in diplomatic correspondence dated more than a year after the appellate court decision and within a few days of argument before the Court itself. *Sumitomo Shoji America, Inc. v. Avagliano*, 457 U.S. 176, 184 n. 9, 102 S.Ct. 2374, 2379 n. 9, 72 L.Ed.2d 765 (1982). Therefore, we deny the motions to strike.

II. The Merits

The court's "role is limited to giving effect to the intent of the Treaty parties." *Sumitomo*, 457 U.S. at 185, 102 S.Ct. at 2380;

accord Great-Western Life Assurance Co. v. United States, 678 F.2d 180, 183, 230 Ct.Cl. 477 (1982) (treaties must be construed to enforce intent of contracting parties). Because we deny the motions to strike, the record now reveals the intent of each government. Since both treaty parties agree that paragraph 2 was not intended to create an exemption from United States domestic taxation, the trial court's decision cannot be upheld. It is the government, not the taxpayers, which is entitled to judgment as a matter of law. Therefore, we reverse the decision of the Claims Court and direct that summary judgment be granted in favor of the appellant.

III. Costs

The government is denied its costs.

REVERSED

BISSELL, Circuit Judge, Additional Views, in which SMITH, Circuit Judge, joins.

While it is proper for this court to take judicial notice of the new evidence, introducing it hours before oral argument is certainly not something I want to encourage. The government has been on notice since the Coplins' case was filed in August 1981 that there would be judicial review of its interpretation of the Implementation Agreement's paragraph 2. During the more than four years that have elapsed there was ample opportunity to obtain the Panamanian interpretation of that provision. Indeed, the Claims Court repeatedly offered the government the opportunity to supplement the record with evidence of the official Panamanian position; the government "steadfastly refused." *Coplin*, 6 Cl.Ct. at 147. Moreover, as late as November 30, 1984, the government gave no hint it was about to introduce new evidence. To the contrary, commenting on its "refusal in this case to approach the government of Panama," the government reconfirmed its position: "The United States has consistently believed that there is no need to request that the Government of Panama supply its interpretation of Article XV, paragraph 2. . . ." Brief for Appellant at 46. Then, without

notice and only one working day before oral argument, the government suddenly revealed the diplomatic note to the taxpayers. Under these circumstances, to require the taxpayers to bear even their own costs borders on the unconscionable. Therefore, I would have the government pay the taxpayers' costs.

NIES, Circuit Judge, with whom RICH and BALDWIN, Circuit Judges, join, concurring.

I concur in the result of the majority decision that United States citizens employed by the Panama Canal Commission are not exempt from United States income taxes by Article XV of the Agreement in Implementation of Article III of the Panama Canal Treaty. A complete reading of the record, the treaty and the Implementation Agreement leads me to conclude that Article XV had no relevance to taxation by the United States of its own citizens. As held in *Corliss v. United States*, 567 F.Supp. 162, 164 (W.D.Ark.1983):

> When taken as a whole, the Court believes the import of Article XV is that the United States seeks to protect its agency, the Canal Commission, and its employees who work for that agency, from taxation by Panama on property or work activities other than private business activities in Panama unrelated to the Commission and property used in these activities.

Accord, Highley v. United States, 574 F.Supp. 715 (M.D.Tenn.1983).

With this understanding of the import of the entire Article, there is no need to construe the words "any taxes" in paragraph 2 other than literally. One need simply identify the Article by the title, "Taxation by the Republic of Panama," rather than "Taxation" *simpliciter*.

With respect to the late filed concurrence by the Panamanian government with the interpretation by the U.S. State Department, that evidence was not necessary to the above decisions and is not necessary here. It merely confirms the most reasonable interpretation of the Article.

APPENDIX B

UNITED STATES CLAIMS COURT

JULY 30, 1984

No. 517-81T.

PAUL H. COPLIN, *et ux.*,

Plaintiffs,

v.

THE UNITED STATES,

Defendant.

United States citizen employed by Panama Canal Commission claimed a refund of all United States taxes paid on income derived from his employment with the commission. Cross motions for summary judgment were filed. The Claims Court, Kozinski, C.J., held that: (1) the President was acting within scope of his authority when he signed implementation agreement governing taxation of the Commission, its contractors and employees, and (2) there was no showing that provision that United States citizen employees are exempt from "any taxes" on income received as a result of their work for the Commission did not mean what it says.

Plaintiff's motion granted; defendant's motion denied.

See also 1 Cl.Ct. 144.

OPINION

KOZINSKI, Chief Judge.

Paul H. Coplin[1] is a United States citizen employed by the Panama Canal Commission. He claims a refund of all United

[1]Patricia Coplin is named as a plaintiff because she signed a joint income tax return with her husband.

States taxes paid on income derived from his employment with the Commission during 1979. Plaintiff bases his claim on Article XV of the Agreement in Implementation of Article III of the Panama Canal Treaty. He claims that this provision exempts all U.S. citizens from taxation of income derived by virtue of their employment with the Commission. The parties have submitted the case for decision on cross-motions for summary judgment.

FACTS[2]

On September 7, 1977, after many years of negotiation, the United States and the Republic of Panama signed the Panama Canal Treaty, T.I.A.S. No. 10030 [hereinafter cited as Panama Canal Treaty], and the Treaty Concerning the Permanent Neutrality and Operation of the Panama Canal, T.I.A.S. No. 10029.[3] The Panama Canal Treaty superseded certain existing treaties between the United States and the Republic of Panama, particularly the Isthmian Canal Convention of November 18, 1903. 33 Stat. 2234, T.S. No. 431. Under the terms of the 1903 Convention, Panama had granted to the United States, in perpetuity, not only the right to build the canal, but exclusive sovereign rights over the ten-mile-wide zone traversed by the canal.

The Panama Canal Treaty restored to Panama territorial sovereignty over the Canal Zone. Panama, in turn, granted to the United States the right to manage, operate and maintain the canal until the year 2000. Operation of the canal during this period is entrusted to the Panama Canal Commission, an agency of the United States. The treaty provides for increasing participation by the Republic of Panama in the management and defense of the canal, in preparation for its assumption of

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[2]The background facts, which are not in dispute, are elegantly summarized in a portion of defendant's brief that the court has adopted with only minor revisions.

[3]The Neutrality Treaty provides for both parties to defend the canal and to keep it open to the ships of all nations.

full responsibility for the canal's operation upon expiration of the treaty.

Because the Canal Zone would no longer be subject to United States territorial sovereignty, it was necessary to define the rights and legal status of the Commission and its employees vis-a-vis each country. These matters were to be governed by the Agreement in Implementation of Article III of the treaty. Agreement in Implementation of Article III of the Panama Canal Treaty, Sept. 7, 1977, United States-Panama, T.I.A.S. No. 10031 [hereinafter cited as Implementation Agreement]. The Implementation Agreement contains 21 articles governing such subjects as use of land and water areas, use of housing areas, telecommunications, entry and departure, registration of vehicles, exemption from import duties and criminal jurisdiction.[4] Article XV of the agreement deals with taxation of the Commission, its contractors and sub- contractors, and its United States citizen employees and their dependents:

ARTICLE XV

TAXATION

1. By virtue of this Agreement, the Commission, its contractors and subcontractors, are exempt from payment in the Republic of Panama of all taxes, fees or other charges on their activities or property.

2. *United States citizen employees and dependents shall be exempt from any taxes, fees, or other charges on income received as a result of their work for the Commission.* Similarly, they shall be exempt from payment of taxes, fees or other charges on income derived from sources outside the Republic of Panama.

3. United States citizen employees and dependents shall be exempt from taxes, fees or other charges on gifts or inheri-

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[4]The legal status of United States armed forces in the Republic of Panama is governed by the Agreement in Implementation of Article IV of the Panama Canal Treaty. *See* p. 137 & n. 22 *infra*.

tance or on personal property, the presence of which within the territory of the Republic of Panama is due solely to the stay therein of such persons on account of their or their sponsor's work with the Commission.

4. The Coordinating Committee may establish such regulations as may be appropriate for the implementation of this Article. [Emphasis added.]

On September 16, 1977, President Carter transmitted the two treaties to the Senate for its advice and consent. The Agreements in Implementation of Articles III and IV of the Panama Canal Treaty were not formally referred to the Senate, although they were transmitted and considered during the ratification hearings. The treaties were approved by the Senate subject to a variety of amendments, conditions, reservations and understandings. Staff of Senate Comm. on Foreign Relations, 96th Cong., 1st Sess., *Senate Debate on the Panama Canal Treaties: A Compendium of Major Statements, Documents, Record Votes and Relevant Events* 410-14, 493-96 (Comm.Print 1979) [hereinafter cited as *Senate Debate on the Panama Canal Treaties*]. Panama assented to each of these, *id.* at 549-52, 556-60, and the treaties went into effect on October 1, 1979.

ISSUES PRESENTED

Plaintiff reads paragraph 2 of Article XV of the Implementation Agreement as exempting him from U.S. taxation of income he earned as an employee of the Panama Canal Commission. Defendant argues that the Implementation Agreement cannot exempt plaintiff from U.S. taxation because the President is without power to create exemptions to the tax laws by means of an executive agreement not subject to the advice and consent of the Senate. Defendant also argues that even if Article XV could exempt plaintiff from income tax it does not in fact do so because it was intended to bar only Panama, and not the United States, from taxing Commission employees.

DISCUSSION

I.

Nature and Effect of the Implementation Agreement

A.

It is a rare case indeed where the United States takes the position that the President has exceeded his authority in the area of foreign relations. The implications of this argument, where it casts doubt on the validity of an agreement between our government and that of another country, are potentially quite serious. An examination of the Panama Canal Treaty and related documents reveals that the Implementation Agreement formed an integral aspect of the deal we struck with Panama. Article 111(9) of the treaty provides:

> The use of the areas, waters and installations with respect to which the United States of America is granted rights pursuant to this Article, and the rights and legal status of United States Government agencies and employees operating in the Republic of Panama pursuant to this Article, shall be governed by the [Implementation Agreement] signed this date.

The Implementation Agreement thus plays a key role in defining the mutual rights and obligations of the United States and Panama with respect to the operation of the canal. Nevertheless, defendant appears to argue that the Implementation Agreement is void to the extent that it provides what plaintiff says it does.

It is difficult to find a more eloquent description of the calamitous foreign policy implications of defendant's position than defendant's own brief in *Weinberger v. Rossi*, 456 U.S. 25, 102 S.Ct. 1510, 71 L.Ed.2d 715 (1982). *Weinberger* considered the validity of a Base Labor Agreement (BLA) signed by the President with the government of the Philippines. The agreement, which was not ratified by the Senate, gave Filipino citizens preferential consideration for civilian positions on U.S. military bases in the Philippines. The D.C. Circuit had held

that the BLA was repealed by a subsequent Act of Congress. In arguing for reversal, the government noted that the ruling below

> would impliedly "repeal" this Nation's commitment to the Philippines—given in exchange for that country's granting the United States the right to use military facilities located in the Philippines. . . . Such an implied "repeal," however, notwithstanding whatever effect it may have for domestic purposes, would have no effect upon the United States' binding international obligation under the BLA to prefer Filipino citizens for civilian employment on the bases. See L. Henkin, [*Foreign Affairs and the Constitution* 164 (1972)]; [2] C. Hyde, [*International Law Chiefly as Interpreted and Applied by the United States* 1465 (2d rev. ed. 1945)]; *Restatement (Second) of the Foreign Relations Law of the United States* . . . § 145(2).
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> . . . Affirmance of the decision below thus would require the United States to breach what the Philippines views as a key provision of the BLA, with unpredictable consequences for our relations with that country and for the United States' continued use of military facilities located there.
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> . . . It is even more difficult to predict the consequences that a breach of the BLA by the United States would have on its relations with . . . other countries and on the continued availability to the United States of the military facilities located there. One fair assumption, however, is that the court of appeals' decision, unless reversed, undoubtedly will hamper the United States' ability to negotiate for and maintain base rights and other military advantages in the Philippines and elsewhere.

Brief for the Petitioners at 29-31, *Weinberger v. Rossi*, 456 U.S. 25, 102 S.Ct. 1510, 71 L.Ed.2d 715 (1982) (emphasis original; footnotes omitted) [hereinafter cited as *Weinberger* Brief]. The Supreme Court found these arguments persuasive.

In light of these weighty considerations, it is at the very least surprising for the United States now to take the position that the court ought to ignore the terms of the Implementation Agreement because, if it means what plaintiff suggests, the President was acting ultra vires in agreeing to it. Defendant can, of course, argue that plaintiff's interpretation of the agreement is incorrect. That argument is addressed at length below. *See* pp. 125-149 *infra*. That is quite different, however, from suggesting that the court need not even bother construing the disputed paragraph because the President lacked the authority to bind the United States to its terms.

Were the court to accept defendant's argument, the consequences would be no less "unpredictable" than those catalogued so persuasively by the United States in *Weinberger*. The Implementation Agreement is an integral part of a very complex series of arrangements defining the relationship between our country and another; it concerns the Panama Canal, a waterway crucial to trade in peacetime and defense in case of war. *See* S.Exec.Rep. No. 12, 95th Cong., 2d Sess. 77-79, 91, 178-80 (1978) [hereinafter cited as S.Exec.Rep. No. 12]. A ruling that the President lacked authority to bind the United States to a portion of the Implementation Agreement would not, as the government pointed out in *Weinberger*, relieve the United States of its *international* obligation to comply with its terms. *See* 2 C. Hyde, *International Law Chiefly as Interpreted and Applied by the United States* 1465 (2d rev. ed. 1945) [hereinafter cited as Hyde, *International Law*]; Vienna Convention on the Law of Treaties, art. 27, U.N. Doc. A/CONF. 39/27 (1969), *reprinted in* 63 Am.J.Int'l L. 875, 884 (1969) [hereinafter cited as Vienna Convention].[5] If Panama were to consider its interests impaired by such a ruling, it could take

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[5]As defendant has noted, "[a]lthough the Vienna Convention is not yet in force for the United States, it has been recognized as an authoritative source of international treaty law by the courts . . . and the executive branch." *Weinberger* Brief at 16 n. 9 (citations omitted).

steps that would adversely affect our interests.[6] Similarly, our relationship with other countries could suffer. In the words of the *Weinberger* Brief, "[o]ne fair assumption . . . is that . . . [it] will hamper the United States' ability to negotiate" future international agreements.

B.

Fortunately, the court need not confront these unsettling issues because the President had ample authority to bind the

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[6]While the *Weinberger* Brief left somewhat vague the potential consequences of a breach of an executive agreement, the Department of State has been more explicit, recognizing that the other signatory might be entitled to repudiate the agreement, depriving the United States of its benefits thereunder. For example, in 1957 the Department of State commented on H.R. 8704 (the Kilday resolution), which would have prohibited the President from delivering U.S. soldiers who had committed crimes abroad for trial by the host country. The Kilday resolution would have superseded certain Status of Forces Agreements that had been negotiated by the President without the advice and consent of the Senate. The Department of State argued against the Kilday resolution, noting as follows:

> But the greater danger is that our Allies might consider our actions pursuant to H.R. 8704 as in direct violation of our treaties and agreements and consider themselves no longer bound by their provisions. In that case not only would the foreign government have full jurisdiction over our servicemen for all offenses, but we would not have the benefit of any of the other provisions of our agreements which provide for special privileges with respect to such matters as drivers' licenses, exemption from taxation, postal services, procurement of supplies, visas, and the adjudication of civil claims against our forces.
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> . . . .
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> . . . This effect would be magnified if the foreign nations regarded our failure to abide by our agreement as a repudiation of the criminal jurisdiction provisions of the Status of Forces Treaty and similar agreements. In such an eventuality, the foreign state would be fully entitled under international law to try in their own courts all criminal offenses committed by the members of our armed forces within their territorial limits and we would have no legal right to prevent them from so doing.

Murphy, *Views of Department of State on House Resolution 8704*, 37 Dep't St.Bull. 317, 319-21 (1957) (emphasis original).

United States to all terms of the Implementation Agreement. *Dames & Moore v. Regan*, 453 U.S. 654, 101 S.Ct. 2972, 69 L.Ed.2d 918 (1981), established—if doubt existed before—that the President has significant powers to bind the United States to international agreements without the advice and consent of the Senate. Such agreements supersede prior United States law to the extent it is inconsistent. In *Dames & Moore*, for example, the President had signed executive agreements known as the Algiers Accords abrogating the rights of United States nationals to sue the government of Iran in our courts. The Supreme Court ruled that the President's action "effected a change in the substantive law." *Id.* at 685, 101 S.Ct. at 2989. While the Court noted that the abrogation of existing rights might constitute a taking, *id.* at 688-90, 101 S.Ct. at 2991-92, it upheld the President's authority to unilaterally change domestic law by executive agreement with a foreign state, *see id.* at 685-86, 101 S.Ct. at 2989-90; *accord United States v. Pink*, 315 U.S. 203, 230, 62 S.Ct. 552, 565, 86 L.Ed. 796 (1942) (international compacts and agreements are the " 'Law of the Land' under the supremacy clause"); *United States v. Belmont*, 301 U.S. 324, 330-31, 57 S.Ct. 758, 760-61, 81 L.Ed. 1134 (1937) (same).

Of course, the President's power to unilaterally dislocate domestic law is not without bounds. In *Dames & Moore*, the Court carefully reviewed the validity of the President's action by applying the classic analysis of Mr. Justice Jackson's concurrence in *Youngstown Sheet & Tube Co. v. Sawyer*, 343 U.S. 579, 634, 72 S.Ct. 863, 888, 96 L.Ed. 1153 (1952). It noted that the President signed the Algiers Accords with the knowledge and approval of Congress. "In such a case," the Court held, "the executive action 'would be supported by the strongest of presumptions and the widest latitude of judicial interpretation, and the burden of persuasion would rest heavily upon any who might attack it.' " *Dames & Moore*, 453 U.S. at 668, 101 S.Ct. at 2981 (quoting *Youngstown Sheet & Tube*, 343 U.S. at 637, 72 S.Ct. at 871 (Jackson, J., concurring)). The Court therefore upheld the President's action even though the Algiers Accords

were not formally approved by the Senate pursuant to article II, section 2 of the Constitution.

It is difficult to imagine a case where the President's power to bind the United States by executive agreement would be less subject to challenge. Article III of the treaty refers to the Implementation Agreement, providing that it "shall govern the rights and legal status of United States Government agencies and employees operating in . . . Panama." The Foreign Relations Committee specifically noted that the Implementation Agreement "will be entered into pursuant to the authority of [the] treaty." S.Exec.Rep. No. 12, at 75.[7] The text of the agreement was submitted to the Senate for its review and the Senate in fact gave it careful consideration. *See, e.g., Panama Canal Treaties: Hearings Before the Senate Comm. on Foreign Relations*, 95th Cong., 1st Sess. Part 1, at 268-69 (1977); Part 3, at 702-11 (1977); Part 5, at 117-21 (1978) [hereinafter cited as *Treaty Hearings*]. The Report of the Foreign Relations Committee recommending ratification of the treaties summarized and discussed the Implementation Agreement and other related documents. S.Exec.Rep. No. 12, at 34-35. There is no doubt that, in consenting to the ratification of the Panama Canal Treaty, the Senate considered and approved the Implementation Agreement and intended that it go into effect under the authority of the treaty.

The principles governing this issue are so well established that citation of further authority would be superfluous were there not a Supreme Court case squarely on point. *Wilson v. Girard*, 354 U.S. 524, 77 S.Ct. 1409, 1 L.Ed. 1544 (1957), considered whether "an Administrative Agreement covering,

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[7]Treaties, like other laws, can form the basis of the President's authority to enter into executive agreements with other states. *Wilson v. Girard*, 354 U.S. 524, 526-29, 77 S.Ct. 1409, 1410-12, 1 L.Ed. 1544 (1957); *see also Dole v. Carter*, 444 F.Supp. 1065, 1068 (D.Kan.), *motion for injunction denied*, 569 F.2d 1109 (10th Cir.1977); Restatement (Second) of the Foreign Relations Law of the United States § 119 (1965); Cong. Research Serv., *The Constitution of the United States of America—Analysis and Interpretation*, S.Doc. No. 82, 92d Cong., 2d Sess. 509-11 (1973).

among other matters, the jurisdiction of the United States over offenses committed in Japan by members of the United States armed forces" was valid. *Id.* at 527, 77 S.Ct. at 1410. The agreement was authorized by a provision in a treaty with Japan that was almost identical to the relevant language of Article III of the Panama Canal Treaty. Security Treaty, Sept. 8, 1951, United States-Japan, art. III, 3 U.S.T. 3329, T.I.A.S. No. 2491. As in this case, the agreement was signed and submitted to the Senate for its review during the ratification process. The Court held:

> In the light of the Senate's ratification of the Security Treaty after consideration of the Administrative Agreement, which had already been signed, and its subsequent ratification of the NATO Agreement, with knowledge of the commitment to Japan under the Administrative Agreement, we are satisfied that the approval of Article III of the Security Treaty authorized the making of the Administrative Agreement and the subsequent Protocol embodying the NATO Agreement provisions governing jurisdiction to try criminal offenses.

Wilson v. Girard, 354 U.S. at 528-29, 77 S.Ct. at 1411-12.

The position urged by defendant appears to be squarely in conflict with this established body of Supreme Court caselaw.[8] The only authority defendant cites in support of its position is *Security Pacific National Bank v. Iran*, 513 F.Supp. 864, 872 (C.D.Cal.1981). *Security Pacific* addressed the issue that was eventually presented to the Supreme Court in *Dames & Moore* and appears to have reached the same conclusion. Of course, if there were an inconsistency between *Security Pacific* and *Dames & Moore*, there can be no doubt as to which case controls. If defendant knows how its position here can be squared with the Supreme Court's rulings in cases such as

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[8]Defendant's position also appears to be contrary to the position it has taken in other cases. *See, e.g.*, Brief for the Federal Respondents at 41-43, 50-53, *Dames & Moore v. Regan*, 453 U.S. 654, 101 S.Ct. 2972, 69 L.Ed.2d 918 (1981).

Dames & Moore and *Wilson v. Girard*, it has failed to articulate its rationale to this court or to other courts, some of which have accepted defendant's argument. *See Hollowell v. United States*, No. 82-713-ORL-CIV-EK, slip op. at 4 (M.D.Fla. Nov. 21, 1983); *Swearingen v. United States*, 565 F.Supp. 1019, 1021 (D.Colo.1983); *see also Long v. United States*, No. 83-158, slip op. at 4-5 (D.Or.July 22, 1983) (relying in part on *Swearingen*).[9]

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[9]Litigants have an obligation to research the law and to base their arguments on existing precedent or to suggest reasonable departures from precedent. *See St. Paul Fire & Marine Insurance Co. v. United States*, 4 Cl.Ct. 762, 770 (1984); Model Rules of Professional Conduct Rule 3.1 (1983). A party may not ignore apparently controlling authority while urging a court to rule in a manner inconsistent therewith. The court is therefore troubled by defendant's failure to discuss—or even cite—*Dames & Moore* and other relevant cases in its presentation to this court and to other courts that have considered this issue. *See* Memorandum of Law in Support of Defendant's Motion for Summary Judgment and in Opposition to Plaintiff's Motion for Summary Judgment at 11-15, *Rego v. United States*, 591 F.Supp. 123 (W.D.Tenn.1984); Memorandum of Law in Support of Defendant's Motion for Summary Judgment at 11-15, *Harris v. United States*, 585 F.Supp. 862 (S.D.Ga.1984); Memorandum of Law in Support of Defendant's Motion for Summary Judgment and in Opposition to Plaintiffs' Motion for Summary Judgment at 11-15, *Stabler v. United States*, No. CA3-83-0166-R (N.D.Tex. Nov. 30, 1983); Memorandum of Law in Support of Defendant's Motion for Summary Judgment at 11-15, *Hollowell v. United States*, No. 82- 713-ORL-CIV-EK (M.D.Fla. Nov. 21, 1983); Memorandum of Law in Support of Defendant's Motion for Summary Judgment and in Opposition to Plaintiff's Motion for Summary Judgment at 11-15, *Pierpoint v. United States*, No. 83-0354-2 (D.S.C. Oct. 3, 1983); Opposition to Plaintiffs' Cross-Motion for Summary Judgment at 11-15, *Snider v. United States*, No. C83-638V (W.D.Wash. Sept. 23, 1983); Memorandum of the United States in Support of its Motion for Summary Judgment and in Opposition to Plaintiffs' Motion for Summary Judgment at 12-15, *Long v. United States*, No. 83-158 (D.Or. July 22, 1983); Memorandum in Support of Defendant's Motion for Summary Judgment at 7-8 & Defendant's Reply to Plaintiffs' Opposition Memorandum at 3-4, *Swearingen v. United States*, 565 F.Supp. 1019 (D.Colo.1983); Memorandum of the United States in Support of its Motion for Summary Judgment at 11-14, *Watson v. United States*, No. C82-319T (W.D.Wash. June 21, 1983); Pre-Trial Brief for the United States at 11-14 & Memorandum of the United States in Opposition to Plaintiffs' Motion for Summary Judgment and in Support of its Cross-Motion for Summary Judgment at 11-14, *Stokes v. United States*, No. C82-160T (W.D.Wash. June 21, 1983); Defendant's Memorandum in Opposi-

The Implementation Agreement is the paradigm of presidential action in the area of foreign relations supported by specific congressional authorization. It is therefore entitled to "the strongest of presumptions and the widest latitude of judicial interpretation." *Youngstown Sheet & Tube*, 343 U.S. at 637, 72 S.Ct. at 871 (Jackson, J., concurring). It has the force and effect of law. *Accord Watson v. United States*, 592 F.Supp. 701, 705 (W.D.Wash. 1983).

Since the Implementation Agreement has the force of law, it implicitly repeals prior conflicting laws. *See, e.g., Dames & Moore*, 453 U.S. at 685, 101 S.Ct. at 2989; *Tennessee Valley Authority v. Hill*, 437 U.S. 153, 190, 98 S.Ct. 2279, 2299, 57 L.Ed.2d 117 (1978); *Polos v. United States*, 621 F.2d 385, 223 Ct.Cl. 547, 560-61 (1980); *Nebraska Public Power District v. 100.95 Acres of Land*, 719 F.2d 956, 958 (8th Cir.1983). In the area of income taxation, however, there is a statutory mechanism that makes it unnecessary to rely merely upon repeal by implication. *See* 26 U.S.C. § 894(a) (1982). This section provides that "gross income" shall not include any income excluded "by any treaty obligation of the United States." The term "treaty obligation" in section 894 is broad enough to include executive agreements that are signed by the President pursuant to constitutional or statutory authority.

As the Supreme Court recognized in *Weinberger v. Rossi*, "[t]he word 'treaty' has more than one meaning." 456 U.S. at 29, 102 S.Ct. at 1514. Under certain circumstances it may refer only to those international agreements formally entered into by the President and approved by the Senate pursuant to article II, section 2 of the Constitution. *Id.* at 30-31 & nn. 7 & 8, 102 S.Ct. at 1514-1515 & nn. 7 & 8. Frequently, however, when

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tion to Plaintiffs' Motion for Summary Judgment and Reply Memorandum in Support of Defendant's Motion for Summary Judgment at 8-12, *Corliss v. United States*, 567 F.Supp. 162 (W.D.Ark.1983); Memorandum of Law in Support of Defendant's Motion for Summary Judgment at 11-15, *Highley v. United States*, 574 F.Supp. 715 (M.D.Tenn.1983); Memorandum Brief for Respondent at 10-11, *McCain v. Commissioner*, 81 T.C. 918 (1983).

Congress uses the word "treaty" it is also referring to executive agreements that are not formally approved by the Senate and are therefore not article II treaties. *Id.* at 30-31, 102 S.Ct. at 1514-1515; *B. Altman & Co. v. United States*, 224 U.S. 583, 601, 32 S.Ct. 593, 597, 56 L.Ed. 894 (1912) ("a compact . . . negotiated and proclaimed under the authority of [the] President . . . is a treaty").

In *Weinberger v. Rossi*, the court determined that the word "treaty," as used in section 106 of Pub.L. No. 92-129, 85 Stat. 348, 355 (1971), was meant to include executive agreements. One basis for the Supreme Court's conclusion was that the statute in question did not affect the foreign policy of the United States. 456 U.S. at 31, 102 S.Ct. at 1515. In such circumstances, Congress is less likely to use the term "treaty" in a technical, restricted sense and "there is even more reason to construe Congress' use of 'treaty' to include international agreements as well as Art. II treaties." *Id.* Like the statutes in *Weinberger* and *Altman*, section 894 does not directly concern foreign policy and therefore the term "treaty" is likely to have been used in its broader, less technical sense.

Moreover, at the time section 894 was first enacted[10] there were a number of international agreements pertaining to taxation that had been negotiated by the President pursuant to statutory authorization but without Senate approval. *See, e.g.*, Agreement Providing for Relief from Double Income Tax on Shipping Profits, Aug. 24, 1933-Jan. 9, 1934, United States-Ireland, 48 Stat. 1842, E.A.S. No. 56; Agreement Providing for Relief from Double Income Tax on Shipping Profits, Mar. 31-June 8, 1926, United States-Japan, 47 Stat. 2578, E.A.S. No. 3. The practice has continued over the years with the apparent approval of Congress. *See, e.g.*, Agreement Regarding Double Taxation of Aircraft Earnings, Dec. 29-Dec. 31,

[10]Section 894 was originally enacted as section 22(b)(7) of the Revenue Act of 1936. Pub.L. No. 74-740, 49 Stat. 1648, 1658 (1936). It was recodified as section 894 at the time of the 1954 revision of the Income Tax Code. The section was amended in 1966 in a manner not relevant to the point here in issue.

1975, United States-Chile, 27 U.S.T. 1371, T.I.A.S. No. 8252; Agreement Regarding Relief from Double Taxation on Earnings from Operation of Ships and Aircraft, Dec. 21-Dec. 27, 1962, United States- Iceland, 13 U.S.T. 3827, T.I.A.S. No. 5255. In *Weinberger*, the Court noted the existence of such international agreements and concluded that Congress would not have intended to repeal them by implication in passing the legislation there in question. It therefore read the term "treaty" broadly. Similarly, section 894 ought to be read broadly to avoid conflict between the income tax laws and these otherwise valid executive agreements.

Given that the legislative history of section 894 and its predecessor shed absolutely no light on the subject, these considerations lead to the conclusion that the term "treaty" in section 894 ought to be read to include executive agreements such as the Implementation Agreement here in issue.

II.

INTERPRETATION OF ARTICLE XV OF THE IMPLEMENTATION AGREEMENT

A.

The Language and Its Plain Meaning

1. Treaties and other international agreements are contracts between sovereign states. *Santovincenzo v. Egan*, 284 U.S. 30, 40, 52 S.Ct. 81, 84, 76 L.Ed. 151 (1931); *Geofroy v. Riggs*, 133 U.S. 258, 271, 10 S.Ct. 295, 298, 33 L.Ed. 642 (1890). In interpreting such documents, the court must divine and give effect to "the intention of the two governments." *United States v. Texas*, 162 U.S. 1, 36, 16 S.Ct. 725, 732, 40 L.Ed. 867 (1896). Therefore, while international agreements have the force and effect of law, they must be construed more like contracts than like statutes,[11] for the court must consider the interests and

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[11]As noted by Chancellor Kent over a century ago:

> Treaties of every kind, when made by the competent authority, are as obligatory upon nations as private contracts are binding upon indi-

intentions of both parties "to secure equality and reciprocity between them." *Jordan v. Tashiro*, 278 U.S. 123, 127, 49 S.Ct. 47, 48, 73 L.Ed. 214 (1928); *Geofroy v. Riggs*, 133 U.S. at 271, 10 S.Ct. at 298. *See The Amiable Isabella*, 19 U.S. (6 Wheat.) 1, 32-33, 5 L.Ed. 191 (1821). Professor Bishop has noted as follows:

> Even though we may come to speak of multilateral treaties as "international legislation", and they do have many characteristics of legislation in that such treaties make law for those states which become parties to them, we must never forget that international agreements remain basically and fundamentally just that: *agreements*, or contracts between two or more states.

Bishop, *Reservations to Treaties*, 103 Recueil des Cours 245, 255 (1962) (emphasis original) [hereinafter cited as Bishop].

"Interpretation of [a treaty] must, of course, begin with the language of the Treaty itself." *Sumitomo Shoji America, Inc. v. Avagliano*, 457 U.S. 176, 180, 102 S.Ct. 2374, 2377, 72 L.Ed.2d 765 (1982). Indeed, "[t]he clear import of treaty language controls unless 'application of the words of the treaty according to their obvious meaning effects a result inconsistent with the intent or expectations of its signatories.' " *Id.* (quoting *Maximov v. United States*, 373 U.S. 49, 54, 83 S.Ct. 1054, 1057, 10 L.Ed.2d 184 (1963)).[12] In construing treaties, words "are to be

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> viduals; and they are to receive a fair and liberal interpretation, according to the intention of the contracting parties, and to be kept with the most scrupulous good faith. Their meaning is to be ascertained by the same rules of construction and course of reasoning which we apply to the interpretation of private contracts.

1 J. Kent, *Commentaries on American Law* * 174, *cited with approval in Tucker v. Alexandroff*, 183 U.S. 424, 437, 22 S.Ct. 195, 200, 46 L.Ed. 264 (1902), *accord Sullivan v. Kidd*, 254 U.S. 433, 439, 41 S.Ct. 158, 160, 65 L.Ed. 344 (1921).

[12]The International Court of Justice has taken the same view:

> The Court considers it necessary to say that the first duty of a tribunal which is called upon to interpret and apply the provisions of a treaty, is

taken in their ordinary meaning . . . and not in any artificial or special sense impressed upon them by local law." *Geofroy v. Riggs*, 133 U.S. at 271, 10 S.Ct. at 298; *accord Santovincenzo*, 284 U.S. at 40, 52 S.Ct. at 84; *see* Vienna Convention art. 31, 63 Am.J.Int'l L. 885.

Perhaps the simplest and most direct guidance as to how a treaty must be construed comes from Mr. Chief Justice Hughes, who noted as follows:

> [I]t is our duty to interpret [a treaty] according to its terms. These must be fairly construed, but we cannot add to or detract from them.

Valentine v. United States ex rel. Neidecker, 299 U.S. 5, 11, 57 S.Ct. 100, 103, 81 L.Ed. 5 (1936).

2. Paragraph 2 of Article XV of the Implementation Agreement speaks in clear and sweeping terms. It provides that "United States citizen employees [of the Panama Canal Commission] . . . shall be exempt from any taxes . . . on income received as a result of their work for the Commission." This language stands in sharp contrast with that of paragraph 1 of the same article which provides that the Commission itself shall be "exempt from payment *in the Republic of Panama* of all taxes." (Emphasis added.) Paragraph 3 of the same article, dealing with personal property, gift and inheritance taxes of U.S. citizen employees, displays a similar contrast, providing that their "presence . . . *within the territory of the Republic of Panama* . . . due solely . . . [to] their . . . work with the Commission" shall not serve as a basis for the exercise of taxing jurisdiction. (Emphasis added.) Finally, Article XV is titled

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> to endeavor to give effect to them in their natural and ordinary meaning in the context in which they occur. *If the relevant words in their natural and ordinary meaning make sense in their context, that is an end of the matter.*

Competence of the General Assembly for the Admission of a State to the United Nations, 1950 I.C.J. 4, 8 (Advisory Opinion of Mar. 3) (emphasis added).

simply "Taxation" and not "Panamanian Taxation" as one would expect if its subject were limited as defendant suggests. By contrast, Article IX, which provides that the Commission shall give preference to supplies and services obtainable in Panama, is titled "Acquisition of *Panamanian* Supplies and Services." (Emphasis added.) When defining rights and responsibilities of only one of the signatory states, the drafters apparently knew how to so provide.

It is also instructive that when addressing the subject of taxation elsewhere in the treaty documents, the parties were careful to specify which country's taxes were meant. For example, paragraph 9 of Article IX of the treaty provides that vessels passing through the canal "shall be exempt from any taxes . . . by the Republic of Panama." Similarly, paragraph 2(e) of Article XI of the Implementation Agreement, dealing with United States contractors of the Commission, provides that such contractors "shall not be obliged to pay any tax . . . to the Republic of Panama" so long as they are taxed in the United States at a substantially equivalent rate. This is an agreement drafted by sophisticated parties, obviously capable of using precise language.

The Supreme Court has held that "general principles applicable to the construction of written instruments" apply to the construction of treaties. *Tucker v. Alexandroff*, 183 U.S. 424, 436, 22 S.Ct. 195, 200, 46 L.Ed. 264 (1902). Specifically, "the enumeration of certain powers with respect to a particular subject matter is a negation of all other analogous powers with respect to the same subject matter. . . . The rule is curtly stated in the familiar legal maxim, *expressio unius est exclusio alterius*." *Id.* The fact that Article XV, according to its heading, purports to deal with the general subject of taxation, that two of its paragraphs specifically refer to the imposition of taxes by Panama only, and that the parties were careful elsewhere in the treaty to specify the taxing authority being addressed, all support plaintiff's interpretation of paragraph 2. Indeed, a fair reading of the language in question leads to the conclusion that it unambiguously exempts U.S. citizens who

are Commission employees from taxation by Panama as well as the United States. *Accord Harris v. United States*, No. CV 183-077, slip op. at 3 (S.D.Ga. Mar. 21, 1984), *appeal docketed*, No. 84-8424 (11th Cir. May 18, 1984); *Swearingen*, 565 F.Supp. at 1020.[13]

B.

The Position of the United States

Defendant argues that the treaty language should not be construed in accordance with its plain meaning because to do so would do violence to the intention of the signatories. A court ought not, of course, give literal effect to treaty language if it is persuaded that such language does not reflect the intention of the high contracting parties. *See, e.g., Sumitomo Shoji*, 457 U.S. at 180, 102 S.Ct. at 2377; *Great-West Life Assurance Co. v. United States*, 678 F.2d 180, 230 Ct.Cl. 477, 481 (1982); Vienna Convention art. 32, 63 Am.J.Int'l L. 885. On the other hand, the court may not simply rewrite the contract to achieve an end it deems desirable. *Choctaw Nation of Indians v. United States*, 318 U.S. 423, 432, 63 S.Ct. 672, 678, 87 L.Ed. 877 (1943). Where the language is reasonably clear, the party proffering a contrary interpretation must persuade the court that its construction comports with the view of *both* parties. *See United States v. Texas*, 162 U.S. at 36, 16 S.Ct. at 732; *see also Sumitomo Shoji*, 457 U.S. at 180, 102 S.Ct. at 2377 (plain meaning of the treaty controls unless it is inconsistent "with the intent . . . of its signatories"). If the court has doubt about the intention of one of the signatories, it cannot ignore the language of the instrument. Absent convincing evidence to the contrary, the court will presume that a party—particularly one

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[13]Defendant's position that the language of Article XV is ambiguous is not entirely unlike that adopted by one of Lewis Carroll's characters: " 'When *I* use a word', Humpty Dumpty said, in a rather scornful tone, 'it means just what I choose it to mean—neither more nor less.' " *Through the Looking Glass*, in The Complete Works of Lewis Carroll 121, 196 (1939), *quoted with approval in Tennessee Valley Authority v. Hill*, 437 U.S. at 173 n. 18, 98 S.Ct. at 2291 n. 18.

of some sophistication like a sovereign state— understood and agreed to the language as written.

Defendant raises three arguments in support of its contention that Article XV was meant to bar only Panama and not the United States from taxing Commission employees. First, it asserts that Panama could have no interest in whether the United States taxes its citizens who work for the Panama Canal Commission. To support this contention, it relies on the negotiating history of Article XV and on the "common sense" notion that the United States would not bargain with other countries as to when and how it will tax its own citizens.

Next, defendant argues that its interpretation is entitled to significant, perhaps controlling, weight. It supports this argument by reference to a number of Supreme Court opinions that, indeed, stand for the proposition that courts ought to afford substantial deference to interpretations of treaties by agencies of the Executive Branch.

Finally, defendant argues that the United States Senate intended Article XV to operate only against Panama and not the United States. It points to the legislative history of the ratification proceedings and suggests that Article XV ought to be interpreted so as to reflect the intention of Congress as expressed during its deliberations.

The court considers each of these arguments in turn.

1. The Negotiating History

a. Before delving into the negotiating history, the court notes that the record presented poses considerable obstacles to a determination of what the parties intended when they agreed to Article XV of the Implementation Agreement. Defendant has produced parts of 18 documents (apparently all previously classified) consisting of telegrams, speech outlines, transcripts of negotiating sessions and State Department memoranda, all concerning negotiations between the United States and Panama on the subject of taxation of United States citizens employed by the Panama Canal Commission. The documents

cover the period from June 30 to August 12, 1977, the latter date being marked by correspondence from President Carter to Congress advising that our negotiators had tentatively reached agreement with Panama on all terms of the treaties and related documents. Defendant informs the court that these are all of its contemporaneous negotiating records pertaining to what eventually became Article XV of the Implementation Agreement. In addition, plaintiff has provided an affidavit from a Panamanian negotiator relating events at a negotiating session not mentioned in defendant's documents.

The materials presented leave many questions unanswered. For example, there is *no* contemporaneous evidence as to the meaning either party placed on the language of Article XV that is the subject of this controversy. Moreover, there is *no evidence whatsoever* as to the interpretation given this language by Panama. *But see* n. 16 *infra*. While the record provides valuable insights as to the interests and motivations of the parties, the court is left largely to surmise and conjecture as to how they resolved their differences and what might have motivated each side to agree to the language finally adopted.

This is far from an ideal basis on which to resolve such a difficult and sensitive issue. The court therefore suggested that the record be supplemented at trial or through additional documentation. As is more fully discussed below, this suggestion was rejected. *See* pp. 42-44 *infra*. With some reluctance, therefore, the court examines the evidence presented to determine whether it supports defendant's assertion that the negotiating history is consistent with its interpretation of Article XV.

b. The record presented—sketchy though it be—paints a far more complex picture of what happened at the negotiating table than defendant's argument would suggest. It is clear that the United States and Panama held widely divergent views on the subject of taxation of Commission employees. Surprisingly, however, this was not principally a quibble over tax revenues. The dispute centered largely on a fundamental disagreement as to the nature and status of the Panama Canal Commission.

The United States viewed the Commission as an agency of the U.S. Government, much like other government agencies conducting U.S. Government business abroad. Our negotiators were concerned that acquiescing to demands that Panama be allowed to tax Commission employees would be tantamount to permitting taxation of the U.S. Government. They also feared that yielding on this issue could expose the United States to the demands of other governments that might wish to tax employees of U.S. agencies operating on their soil. This theme, which was echoed again and again, is perhaps best summarized by an excerpt from the statement of U.S. Ambassador Sol M. Linowitz during the June 30, 1977, negotiating session held in Washington, D.C.:

> [O]n the Income Tax question which you raised with us . . . I can tell you this: We have explored this carefully with the Treasury Department and with the legal people involved with the Internal Revenue Service—and it does pose a very great problem.
>
> This is not done anywhere in the world. No employee of a government, of the United States Government or of a government agency, is now subject to taxes in a foreign country; and it would therefore, call for a wholly new approach to this problem—which is being very strongly resisted.

Motion of the United States for Summary Judgment and Brief in Support Thereof at 48 (filed Nov. 22, 1983) [hereinafter cited as Defendant's Brief].

The Panamanians viewed the matter quite differently. To them, the Panama Canal Commission was not merely a United States agency conducting U.S. Government operations in Panama. They viewed the Commission as a commercial enterprise operated jointly by the two governments, fundamentally different from agencies performing purely governmental functions on behalf of the United States alone. This view was summarized by Ambassador Romulo Escobar Betancourt of Panama at the July 12, 1977, negotiating session:

> Now, I understand the view that you put forward here yesterday . . . that in your case there's no precedent anywhere in the world for this. But if I understood the argument advanced, there haven't been any cases either in which you've had an operation like this—a joint operation between two countries.
>
> We're not talking about income tax to be paid by the military assigned to Panama; we're talking about income tax to be paid by citizens whose wages would be derived from the Panama Canal. In other words, the salaries to be paid by the U.S. nationals don't come from the United States but, rather, they would be derived from the operation of the Canal. So maybe they could be allowed to pay taxes in Panama since from here on they'll be working under Panamanian jurisdiction and using Panamanian services.

Defendant's Brief at 73-74.[14]

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[14]The Panamanian position was not without support. While the Panama Canal Treaty and the Implementation Agreement refer to the Commission as an agency of the United States, Panama Canal Treaty art. III (3); Implementation Agreement art. I (1), its structure and operation differ in fundamental respects from the typical U.S. Government agency. For example, the Commission is supervised by a board composed of nine members, four of whom must be Panamanian nationals proposed by Panama. Panama Canal Treaty art. III(3)(a). The United States may not unilaterally remove any of the Panamanian members, but must reach agreement with Panama on any proposed removal. *Id.* art. III (3)(b). Upon removal of a Panamanian member, Panama may propose a replacement. *Id.* Until 1990, the Administrator of the Commission shall be an American and the Deputy Administrator a Panamanian. *Id.* art. III (3)(c). Starting in 1990 and until the treaty expires in the year 2000, the Administrator shall be Panamanian and the Deputy, American. *Id.* The treaty also provides for the appointment of a Panama Canal Consultative Committee, composed of an equal number of Americans and Panamanians, to advise the two governments on matters of policy affecting the canal. *Id.* art. III(7). In addition, th . treaty calls for the employment of increasing numbers of Panamanian employees at all levels, "with the objective of preparing, in an orderly and efficient fashion, for the assumption by the Republic of Panama of full responsibility for the management, operation and maintenance of the Canal upon the termination of this Treaty." *Id.* art. III(8).

An exchange from the July 14, 1977, negotiating session reveals that the Panamanian negotiators were uncomfortable with the U.S. view that operation of the canal would continue to be an exercise of U.S. sovereign authority within their territory:

> **[Mr. Rodrigo] Gonzales [of Panama]:** . . . [I]f the National Bank of Panama, an agency of the government, established a branch in the US, its Panamanian employees would be liable to pay American income tax. The same thing applies to foreign workers in Panama. . . . Another example is Volvo, a government-owned company, which has set up assembly plants in the US. Both its American and Swedish workers pay US income tax.
>
> **[Ambassador Ellsworth] Bunker [of the United States]:** US government employees do not pay income tax anywhere in the world.
>
> [Minister Aristides] Royo [of Panama]: We must recognize the changing situation, that this Zone will no longer be a place where American workers are subjected to US jurisdiction, laws, police and courts. The situation now will be one in which American workers, although employed by the American government, will be subjected to a foreign jurisdiction, police, as the colonial status will cease to exist.

Defendant's Brief at 79-80. Minister Royo's final comment suggests that the Panamanian position was animated at least in part by a desire to alter as much as possible the pre-treaty situation where the United States exercised full sovereignty in operating the canal.

As disclosed by a State Department briefing paper prepared on July 8, 1977, the United States was well aware of the motivations of the Panamanian negotiators and appreciated that this was not principally a dispute over revenues:

> *Suggested Position and Strategy:*

We should not agree to taxation of U.S. citizen employees. Since taxation of U.S. employees would not yield very much in new revenues [remainder of sentence classified].

Supporting Arguments:

—Taxation of U.S. employees by a foreign country would be tantamount to taxation of the [U.S. Government]. This is not acceptable international practice.

—While it is international practice to tax employees of government trade organizations, airlines etc. on the basis that these enterprises fulfill a commercial function, government employees engaged in governmental activities are not taxed.

—Contrary to Panama's argument, we have always managed the waterway as a government—not a commercial—facility. Personnel policies, toll structures and financial practices reflect this. The Canal is, in effect, a government monopoly, not a commercial enterprise, and its employees should be treated accordingly.

. . . .

-Panama may be raising this as an issue to assert its "sovereign right" to tax persons resident within its jurisdiction. The money involved is not important to the [Government of Panama], but the principle is. At current Panamanian tax rates, tax payments by US employees would total approximately $2 million per annum (average U.S. employee taxable income is $11,000+). [Remainder of paragraph classified.]

Defendant's Brief at 62-63 (emphasis added).

[Paragraph deleted from published version of opinion.][15]

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[15]Certain materials pertaining to the negotiating history are still classified and were examined by the court ex parte. The portion of the opinion discussing classified information has been separately filed in camera and is subject to dissemination only pursuant to a separate order.

As the negotiations progressed, the positions of the parties hardened and their differences grew wider rather than narrower. As Ambassador Linowitz noted at the July 11, 1977, negotiating session, "these problems have been even intensified in our further discussions." Defendant's Brief at 56.

The last negotiating session for which we have a contemporaneous record was held on July 18, 1977, in Washington and there appears to have been no specific discussion of this issue. However, a memorandum from U.S. Ambassadors Bunker and Linowitz to the Secretary of State indicates that the issue had not been resolved as of July 21. The memorandum, which provides "talking points" for the Secretary, continues to reflect the U.S. position that taxation of Canal Commission employees by Panama would set an undesirable precedent and that the monetary gain to Panama would be relatively small. In addition, the memorandum suggests that a U.S. concession on this point "would be the type of issue which treaty opponents could use to considerable advantage." Defendant's Brief at 95.

At this point, the contemporaneous record of negotiations abruptly ceases. It is important to note that the language that eventually became Article XV of the Implementation Agreement was not considered during any of the sessions for which we have a transcript or other contemporaneous documentation. Indeed, information provided by the U.S. Government does not disclose when this language was first considered, what if anything was said about it, or even who was in attendance. Curiously, the only evidence we have on the consideration of the Article XV language comes from *plaintiff* by means of the Affidavit of Dr. Carlos Alfredo Lopez Guevara, Panama's Ambassador Extraordinary and Plenipotentiary for Canal Treaty negotiations. Ambassador Guevara reports that the parties met a last time in Panama during August and that the language in question was presented by the United States during that session. According to Ambassador Guevara, "[the] text [of paragraph 2] was tabled without explanation and no objection was raised by the Panamanian Delegation. Therefore, it was

agreed." Affidavit of Dr. Carlos Alfredo Lopez Guevara ¶ 5 (filed Mar. 8, 1984) [hereinafter cited as Guevara Affidavit].[16]

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[16]Ambassador Guevara goes on to state that the language of paragraph 2 was intended to preclude both the United States and Panama from taxing American employees of the Commission, that it was so read by Panama, and that a contrary interpretation by the United States would be viewed as a material breach of the treaty. Guevara Affidavit ¶¶ 6, 7.

Defendant has objected to this portion of the Guevara affidavit arguing that "it simply is an opinion after the fact. It's not contemporaneous. It was prepared in preparation of this lawsuit." Official Transcript in the Matter of *Coplin v. United States*, Feb. 23, 1984, at 26 [hereinafter cited as Feb. 23 Transcript]. Defendant's position on the admissibility of this type of evidence has been less than consistent. Appended to defendant's brief is the Affidavit of Michael G. Kozak, Deputy Legal Advisor for the United States Department of State. Mr. Kozak states that between 1973 and 1977 he served as a member of the U.S. negotiating team for the Panama Canal Treaty and "participated directly in the negotiation of the Panama Canal Treaty and of the Agreements in Impiementation thereof." Affidavit of Michael G. Kozak ¶ 3 (Dec. 8, 1982), *reprinted in* Defendant's Brief at 19. Mr. Kozak notes that he was "one of the principal drafters of the Treaty and of the Agreements in Implementation of Articles III and IV thereof." *Id.* ¶ 4. Mr. Kozak does not claim to have been present at the negotiating session where the language of Art. XV was considered nor do we have any other indication that he was there. *See* pp. 142-143 *infra*. Nevertheless, he opines as follows:

> The purpose of the pertinent language of Article [ ] XV . . . [is] to ensure that United States citizen employees of the Canal Commission . . . would not be subject to host-country [i.e., Panamanian] taxation.

Id. ¶ 11. Defendant relied on the Kozak Affidavit to support its Requested Finding of Fact No. 6 pertaining to the purpose of Article XV. It is anomalous for defendant to object to the statement of Ambassador Guevara regarding the meaning of the language in question, but to tender the statement of Mr. Kozak on the very same point.

Defendant now concedes that the Kozak Affidavit may not be used to divine the purpose of Article XV. Feb. 23 Transcript at 30-32. Defendant has also suggested that reliance on the Kozak Affidavit to support its proposed finding as to intent was inadvertent. Reply Brief for the United States in Support of its Motion for Summary Judgment at 7 n. 4 (filed Jan. 23, 1984). Defendant has not, however, explained why paragraph 11 of the Kozak Affidavit was presented at all, given its position as to the admissibility of post-hoc statements by negotiators. Moreover, the Kozak Affidavit, in the very form presented to this court, has been presented to other courts that have considered this issue. *See* n. 9 *supra*. Some of those courts have expressly relied on

c. Defendant appears to overlook the fundamental issue in these negotiations when it argues that Article XV was not

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it. *See, e.g., Stabler v. United States*, No. CA3-83-0166-R, slip op. at 3 (N.D.Tex. Nov. 30, 1983); *Pierpoint v. United States*, No. 83-0354-2, slip op. at 5-6 (D.S.C. Oct. 3, 1983). Other courts may have been swayed by the affidavit without specifically mentioning it.

Whether a court may consider non-contemporaneous statements of negotiators for purposes of divining the intention of the parties is, in fact, a difficult and unsettled question. At least one Supreme Court opinion seems to suggest that such evidence is not admissible. *Arizona v. California*, 292 U.S. 341, 359-60, 54 S.Ct. 735, 742-43, 78 L.Ed. 1298 (1934) (Brandeis, J.). It is unclear the extent to which the ruling in *Arizona* is bound up in the specific facts of that case and whether its rationale survives the adoption of the Federal Rules of Evidence. *See United States v. Jacobs*, 547 F.2d 772, 777 (2d Cir.1976), *cert. dismissed*, 436 U.S. 31, 98 S.Ct. 1873, 56 L.Ed.2d 53 (1978) (purpose of Rule 402 "was to bar common law rules of evidence . . . if inconsistent").

International courts and arbitrators have traditionally relied on non-contemporaneous statements of negotiators. For example, in a dispute concerning the Jay Treaty of Nov. 19, 1794, the depositions of John Adams and John Jay, surviving negotiators, were considered, as was a letter from Benjamin Franklin. 1 J. Moore, *International Adjudications* 63-67 (1929). One commentator has argued that where a jury is not involved, "[d]eclarations of [the] negotiators, in so far as they indicate the sense in which terms were employed, are valuable, not merely because they are enlightening, but also because they may be safely entrusted to the consideration of judges or arbitrators." 2 Hyde, *International Law* 1497; *cf. Sumitomo Shoji*, 457 U.S. at 187 n. 10, 102 S.Ct. at 2379 n. 10 (distinguishing government's official position from "evidence of the state of mind of the Treaty negotiators").

Because the issue is unsettled, and because the evidence in question is merely cumulative, the court decides this case *without* reliance on the statements of negotiators on either side as to the intent of the parties. The court notes, however, that insofar as reliance on such statements is deemed relevant and probative, Ambassador Guevara is the only one identified as having been present at the negotiating session where the language of Article XV was actually considered. He is therefore the only one competent to give an opinion as to the intent of the negotiators.

The court does rely on the Guevara Affidavit insofar as it describes the physical events at the August 1977 negotiating session. As an eyewitness participant, his competency to testify as to what he saw and heard is not subject to challenge. Indeed, defendant has largely adopted the Guevara version of what transpired. Official Transcript in the Matter of *Coplin v. United States*, Mar. 8, 1984, at 35-36 [hereinafter cited as Mar. 8 Transcript].

intended to shield Commission employees from U.S. taxation because that possibility was not expressly raised during the negotiating sessions for which we have a record. Equally naive is its assertion that Panama could have no interest in whether the U.S. taxes its citizens who live and work on Panamanian soil and operate the canal in which it has such a significant interest. Defendant's error lies in characterizing the negotiations as turning exclusively on fiscal issues, whereas the record indicates that the controversy was primarily a political one.[17]

To the United States, the question of revenues was of relatively little consequence; it felt, however, that allowing Panama to tax Commission employees would set a bad precedent worldwide. Panama, for its part, appears to have felt that operation of the canal was a joint commercial venture by the two governments, not a continued exercise of U.S. sovereign authority. Putting the matter in terms of other tax conventions to which the United States is a party, our negotiators wanted Commission employees to be treated for tax purposes as if they were performing purely U.S. governmental functions while the Panamanian negotiators wanted Commission employees treated as if they were providing commercial services. *See, e.g.*, Agreement for the Avoidance of Double Taxation and Prevention of Tax Evasion with Respect to Taxes on Income, Apr. 30, 1984, United States-China, art. 18, *reprinted* in 23 Tax Notes 695 (1984) (not yet ratified); Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, June 17, 1980, United States-Denmark, art. 20, *reprinted in* Sen.Exec. Q, 96th Cong., 2d Sess. (1980);

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[17]If the question had been one of revenues alone, it could have been resolved without reference to the tax issue. The parties were in the process of negotiating fees to be paid by the Commission for services provided by Panama. The package ultimately agreed upon called for an initial annuity to Panama of $50-60 million per year. S.Exec.Rep. No. 12, at 100. According to the U.S., Panama would derive no more than $2-3 million from taxing Commission employees. Defendant's Brief at 95. Because this amount was viewed as relatively trivial, it could have been factored into the negotiations for the annuity payment.

(not yet ratified) [hereinafter cited as Denmark Treaty]; Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, July 1, 1957, United States-Pakistan, art. IX, 10 U.S.T. 984, T.I.A.S. No. 4232 [hereinafter cited as Pakistan Treaty]; Convention for the Avoidance of Double Taxation and the Establishment of Rules of Reciprocal Administrative Assistance in the Case of Income and Other Taxes, Mar. 23, 1939, United States-Sweden, art. X, 54 Stat. 1759, T.S. No. 958 [hereinafter cited as Sweden Treaty].[18] So far as this record discloses, neither side gave any indication that it was prepared to yield to the other's position.

The language finally adopted reflected the position of neither party. Indeed, it neatly sidestepped the sensitive sovereignty issue altogether. Without a statement from Panama, it is of course difficult to be certain as to what its motivations might have been in accepting this language. However, several pos-

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[18]As these and other tax treaties demonstrate, the United States is committed to the principle that only those employees performing *governmental* functions will be exempt from host-country taxation. Article VI(2) of the treaty with Canada, for example, provides that the tax exemption "shall not apply to payments in respect of services rendered in connection with any trade or business carried on for purposes of profit by either of the contracting states or by any agency, instrumentality or political subdivision thereof." Convention and Protocol for the Avoidance of Double Taxation and Prevention of Fiscal Evasion in the Case of Income Taxes, Mar. 4, 1942, United States-Canada, art. VI(2), 56 Stat. 1399, T.S. No. 983 [hereinafter cited as Canada Treaty]. Whether operation of the Panama Canal is a profit-making enterprise or performance of a governmental function is a question as to which two states may differ. In that regard, it is worth noting that the technical explanation to a similar provision in a more recent treaty with Canada (not yet ratified) provides that the determination ought to be made "by a comparison with the concept of a governmental function in the State in which the income arises." Technical Explanation of the Convention Between the United States of America and Canada with Respect to Taxes on Income and on Capital, signed at Washington, D.C., on Sept. 26, 1980, art. XIX, *reprinted in* Tax Treaties (CCH) ¶ 1317R. Application of a similar rule to the Implementation Agreement would suggest that the Panamanian conception of what is and what is not a governmental function ought to be given some weight.

sibilities readily come to mind. First, and most obvious, a provision whereby the United States agreed not to tax Commission employees could have been construed by Panama as a recognition of the special status of the Panama Canal Commission. Moreover, an increase in the disposable income of Commission employees (by exempting their salary from U.S. taxation) would leave more for them to spend in Panama, thereby boosting the local economy. Finally, Panama could well have been concerned that Commission employees would be uncomfortable with their new status, suddenly finding themselves on foreign soil rather than on what had been essentially U.S. territory. Panama could have feared an exodus of skilled canal operators and might have been pleased to accept a compromise that made it more attractive for Americans to stay and work for the Commission. In short, the record does not support defendant's assertion that Panama could have had no conceivable interest in whether the United States taxes Commission employees.

From the perspective of the United States, the language of Article XV could also have been viewed as advantageous. By providing that neither country could tax the salary of Commission employees, the United States avoided the possibility of Panamanian taxation and the undesirable precedent it would have set. Moreover, compromise language avoided the danger (noted by Ambassadors Bunker and Linowitz) that the issue might be used by treaty opponents as an argument against ratification. Because the loss of tax revenue was not considered significant, side-stepping the sensitive issue of sovereignty that divided the parties could well have been welcomed by the United States.

To be sure, the language of Article XV did not satisfy all of the concerns of the parties; it was certainly an uneasy compromise. Yet, the time for concluding negotiations was drawing near and there was growing pressure to bring the process to a successful conclusion. *See, e.g.*, N.Y. Times, Aug. 2, 1977, at A1, col. 5; Wash. Post, July 30, 1977, at A2, col. 3; N.Y. Times, July 30, 1977, at A1, col. 3. A compromise that left the sov-

ereignty issue unresolved and allowed each side to claim victory as to its essential concerns seems entirely plausible.

It is conceivable, of course, that in August 1977 the Panamanian delegation decided to abandon its position entirely and embrace the view advanced by the United States. However, there is simply no evidence on this record that this occurred. Certainly, the fact that the Panamanians accepted language that on its face is a *compromise* provides no support at all for the proposition that they capitulated entirely and accepted the U.S. view that they had so forcefully resisted. A fair review of the negotiating history of Article XV leads to the conclusion that in all likelihood the language adopted accurately reflects the agreement reached by the parties.

d. Defendant also suggests that the United States would not have entered into an agreement with Panama as to how it would tax its own citizens, that being an internal matter not the proper subject of negotiation with foreign governments. Despite its common sense appeal, defendant's argument fails because it is based on a false premise.

The fact is that our government regularly enters into treaties and conventions limiting the amount of tax that the United States may collect from its own citizens. The most common type of provision fits under the heading of "relief from double taxation" and precludes the United States from taxing its citizens or residents to the extent that income taxes have been paid to the other signatory to the convention. *See, e.g.*, Pakistan Treaty art. XV; Canada Treaty art. XV; Sweden Treaty art. XIV; U.S. Draft Model Income Tax Convention of June 16, 1981, art. 23, *reprinted in* Tax Treaties (P-H) ¶ 1022. Another situation where the United States has agreed to limit the tax it will impose upon its citizens is in the area of shipping and air transportation. In some treaties, the United States appears to have bound itself not to tax U.S. citizens who operate such businesses in other signatory states. *See* Convention for the Avoidance of Double Taxation with Respect to Taxes on Income, July 22, 1954, United States-Germany, art. V, 5 U.S.T. 2768, T.I.A.S. No. 3133; Sweden Treaty art. IV.

Occasionally, the United States negotiates treaties that exempt certain types of income from taxation by both states. For example, the 1957 treaty with Pakistan contained a "tax sparing" provision. Pakistan Treaty Art. XV(1). Under that provision, American investors in Pakistan would have been allowed a credit consisting not only of taxes paid to Pakistan, but also of taxes waived by virtue of Pakistan's investment incentive program. Under the terms of this provision, certain Americans doing business in Pakistan would have been exempt from taxation by both countries. The Senate adopted a reservation preventing this provision from going into effect because of a change in Pakistani law. It did, however, express its continued interest in this type of arrangement. S.Exec.Rep. No. 1, 85th Cong., 2d Sess. 3 (1958).[19] A more recent treaty signed with Italy (but not yet ratified) exempts certain types of alimony and child support payments from taxation in both jurisdictions. Convention for the Avoidance of Double Taxation with Respect to Taxes on Income and the Prevention of Fraud or Fiscal Evasion, Apr. 17, 1984, United States-Italy, art. 18(3); *see also* Convention with Respect to Taxes on Income and Capital, Sept. 26, 1980, United States-Canada, art. XVIII(6)(b), *reprinted in* S.Exec. T, 96th Cong., 2d Sess. (1980) (alimony and child support payments exempted from U.S. tax if Canada would exclude such payments from the recipient's taxable income). These agreements demonstrate that it is not unprecedented for the United States and another government to agree that certain parties will be exempted from taxation in both jurisdictions.

Contrary to defendant's assertion, therefore, no principle of law, policy or tradition precludes the United States from nego-

[19]The issue nas arisen again from time to time. Exchange of Notes Regarding the Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, Aug. 1, 1977, United States-Morocco, T.I.A.S. No. 10194. Most recently it was considered during the negotiations of the tax treaty between the United States and China signed on April 30, 1984. Exchange of Notes Regarding the Agreement for the Avoidance of Double Taxation and Prevention of Tax Evasion with Respect to Taxes on Income, Apr. 30, 1984, United States-China, *reprinted in* 23 Tax Notes 701 (1984).

tiating with another government as to U.S. taxation of American citizens. When Americans live, work or invest abroad (or when citizens of other countries live, work or invest in the United States) taxation of their income becomes the concern of both states. Under those circumstances, it is not at all unusual for the two governments to apportion the amount of tax collected by each so as to assure fairness or serve some other policy. Such agreements generally contain provisions that limit how much tax the United States may collect from its own citizens and residents, in exchange for reciprocal promises from the other signatory.

The negotiating record indicates that the negotiators considered more traditional approaches such as tax sharing and tax rebating but rejected them because of objections from the United States. That the provision actually adopted is somewhat unorthodox may simply reflect the unusual circumstances surrounding the treaty negotiations and the history of the canal. However, the language adopted is not such a drastic departure from past practice as to render unthinkable the notion that it could have been the product of a deliberate compromise.

2. Deference to the Position of the United States

As the Supreme Court has often noted, the interpretation given a treaty by the Executive Branch of our government is entitled to significant deference. *E.g.*, *Sumitomo Shoji*, 457 U.S. at 184-85, 102 S.Ct. at 2379-80; *Kolovrat v. Oregon*, 366 U.S. 187, 194, 81 S.Ct. 922, 926, 6 L.Ed.2d 218 (1961); *Factor v. Laubenheimer*, 290 U.S. 276, 295, 54 S.Ct. 191, 196, 78 L.Ed. 315 (1933). This deference is based on a number of related considerations. Because the Executive Branch is involved directly in negotiating treaties, it is well situated to assist the court in determining what the parties intended when they agreed on a particular provision. Moreover, treaties normally carry significant foreign policy implications, matters peculiarly within the purview of the political branches of our government. A court should minimize intrusion in the conduct of foreign affairs by adopting the interpretation suggested by the Ex-

ecutive Branch whenever it can fairly do so. Finally, the Executive Branch generally has administrative authority over the implementation of international agreements. As in the case of domestic legislation, a court should generally give great weight to the interpretations of agencies charged with implementation of treaties because such agencies may possess significant expertise in the relevant subject matter.

Deference, however, is not the same as blind acceptance. There is no authority for the proposition that a court construing a treaty must follow the interpretation suggested by our government where that interpretation is unreasonable or runs contrary to what the court determines was the intent of the high contracting parties.[20] Indeed, the Supreme Court has noted that "courts interpret treaties for themselves," *Kolovrat*, 366 U.S. at 194, 81 S.Ct. at 926, and that the construction given by government agencies is "not conclusive," *Sumitomo Shoji*, 457 U.S. at 184, 102 S.Ct. at 2379.[21] *Accord Factor v.*

[20]Our State Department has, in fact, advised other states that "[u]nder the system of government of the United States, a final decision of questions involving the interpretation of laws and treaties, from the standpoint of municipal law, rests with the courts." *Aide memoire* handed the German Ambassador by the Under Secretary of State (Phillips) (May 3, 1933), MS. Department of State, file 611.623 Coal/46, *quoted in* 5 G. Hackworth, *Digest of International Law* 267 (1943).

[21]The principle that courts are not bound by the unilateral interpretations of only one of the signatories is shared by other nations. For example, the French courts have held as follows:

> [B]oth in theory and in present day judicial practice, when a governmental interpretation is unilateral—that is, when it expresses the opinion of one only of the contracting parties—it has a merely advisory effect. But, on the other hand, if the interpretation is agreed upon by both governments, there is, so to speak, a clause added to the treaty which is embodied therein, has the same authority, and, like it, has the binding force of a law.

Societe Ruegger & Boutet c. Societe Weber & Howard, 32 Revue Critique de Droit International 86, 87 (Le Tribunal Civ. de la Seine (3e Ch.)) (1934), *English synopsis in* Annual Digest and Reports of Public International Law Cases 404, 405 (H. Lauterpacht ed. 1940). The effect of a *bilateral* interpretation of the treaty, and the failure of the United States to provide such an interpretation, is discussed at greater length below. See pp. 146-148 *infra*.

Laubenheimer, 290 U.S. at 295, 54 S.Ct. at 196; Restatement (Second) of the Foreign Relations Law of the United States § 150 (1965) [hereinafter cited as Restatement]. The deference afforded depends upon the degree to which the interpretation proffered by our government is reasonable, unbiased and consistent with what appear to be the circumstances surrounding the treaty. As discussed below, there is much on this record that undermines the plausibility of the position taken by the United States, and hence the deference that the court is able to afford to the interpretation it advances in this litigation.

a. The Implausibility of a Drafting Error. In attempting to explain why the language of Article XV does not reflect what it claims was the intention of the parties, defendant has suggested that there has been a drafting error or at least inartful draftmanship. This explanation does not ring true. In the first place, the error the United States now argues it made is so obvious that it fairly leaps from the page even upon a cursory reading of Article XV. This is not a situation where the language used was ambiguous or imprecise; rather, language was used which, in its plain and ordinary meaning, achieves an end that the United States now repudiates.

The Supreme Court has noted that "treaties are the subject of careful consideration before they are entered into, and are drawn by persons competent to express their meaning and to choose apt words in which to embody the purposes of the high contracting parties." *Rocca v. Thompson*, 223 U.S. 317, 332, 32 S.Ct. 207, 210, 56 L.Ed. 453 (1912). This observation is certainly germane here. The record discloses that (aside from our two ambassadors and miscellaneous other negotiators) at least three State Department attorneys were directly involved in the negotiation and drafting process, including the Legal Adviser himself, the highest ranking attorney in the State Department. In addition, this provision was of significance to other agencies of the United States government; the negotiating transcripts specifically mention that the Department of the Treasury was consulted on the issue. It is simply incredible

that in negotiating a sensitive and important provision with a foreign government, with the advice and assistance of so many experienced attorneys and negotiators, the representatives of the United States of America were unable to come up with language that more accurately reflected their intentions.

Nor was this a case where the language was thrown together at the last minute so that our negotiators could not take advantage of the resources at their disposal. The language of Article XV underwent significant revision in the drafting process. According to defendant, the language of Article XV was adapted from a similar provision in the Implementation Agreement pertaining to Article IV of the treaty, the so-called Status of Forces Agreement (SOFA). Agreement in Implementation of Article IV of the Panama Canal Treaty, Sept. 7, 1977, United States-Panama, art. XVI, T.I.A.S. No. 10032. A comparison between Article XV of the Implementation Agreement and the relevant Article of SOFA reveals a significant number of wording changes.[22] In addition, defendant has produced no fewer

[22]The following is the full text of SOFA Article XVI, with all words changed or deleted in drafting the Implementation Agreement emphasized:

> (1) By virtue of this Agreement, *the United States Forces* are exempt from payment in the Republic of Panama of all taxes, fees or other charges on their activities or property, *including those imposed through contractors or subcontractors.*
>
> (2) *Members of the Forces or the civilian component*, and dependents, shall be exempt from any taxes, fees, or other charges on income received as a result of their work for the *United States Forces or for any of the service facilities referred to in Articles XI or XVIII of this Agreement.* Similarly, *as is provided by Panamanian law*, they shall be exempt from payment of taxes, fees or other charges on income derived from sources outside the Republic of Panama.
>
> (3) *Members of the Forces or the civilian component*, and dependents, shall be exempt from taxes, fees or other charges on gifts or inheritance or on personal property, the presence of which within the territory of the Republic of Panama is due solely to the stay therein of such persons on account of their or their sponsor's work with the *United States Forces.*
>
> (4) *The Joint Committee* may establish such regulations as may be appropriate for the implementation of this Article.

than four intermediate drafts, prepared over the course of several weeks. *See* Defendant's Response to Plaintiffs' Interrogatories at 2 (no. 2) (filed June 11, 1984). The language of Article XV quite clearly was subject to careful scrutiny and manipulation before the drafters were satisfied that it accurately expressed their intentions.

It is of particular significance that during the drafting process the phrase "as provided by Panamanian law" was deleted from the second sentence of paragraph (2) of the SOFA. *See* n. 22 *supra*. This language in the SOFA firmly anchors the subject matter of its paragraph (2) to Panamanian law. Experienced attorneys would surely have appreciated the negative inference raised by deleting such language from the equivalent paragraph of the Implementation Agreement. Moreover, the deletion suggests that the drafters were aware that Panamanian law would not otherwise exempt Commission employees from taxation; this was an issue raised by Panama during the negotiations.[23] This careful tailoring of the language of Article XV and particularly the very paragraph here in issue, does not square with defendant's theory of error through unthinking adoption of boilerplate language.

Finally, Status of Forces Agreements with other countries contain provisions that are similar to Article XV of the Implementation Agreement, except for the fact that they are very specific about which country is providing the tax exemptions. For example, the NATO SOFA provides that "[m]embers of a force or civilian component shall be exempt from taxation *in the receiving State*." North Atlantic Treaty, June 19, 1951, art. X(1), 4 U.S.T. 1792, T.I.A.S. No. 2846 (emphasis added); *see also* Agreement Under Article IV of the Mutual Defense Treaty Regarding Facilities and Areas and the Status of United States Armed Forces in the Republic of Korea, July 9, 1966, United States-Korea, art. XIV(2), 17 U.S.T. 1677, T.I.A.S. No. 6127 (exemption from payment of "any Korean taxes to the

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[23]Defendant's Brief at 79 (Statement of Mr. Rodrigo Gonzalez during the July 14, 1977, negotiating session).

Government of the Republic of Korea"); Agreement Regarding Status of United States Forces in Australia, May 9, 1963, United States- Australia, art. 6(1), (2), 14 U.S.T. 506, T.I.A.S. No. 5349 (exemption from "Australian tax" and "taxation under the laws of the Commonwealth of Australia"); Agreement Under Article VI of the Treaty of Mutual Cooperation and Security: Facilities and Areas and the Status of United States Armed Forces in Japan, Jan. 19, 1960, United States-Japan, art. XIII(2), 11 U.S.T. 1652, T.I.A.S. No. 4510 (exemption from payment of "any Japanese taxes to the government of Japan"); Agreement Regarding Status of United States Forces in Lebanon, July 31-Aug. 6, 1958, United States-Lebanon, 10 U.S.T. 2166, T.I.A.S. No. 4387 (exemption from "any form of taxation in Lebanon"). In the words of Mr. Chief Justice Hughes, "[w]e must assume that the representatives of the United States had these clauses before them when they negotiated [the Implementation Agreement] and that the omission was deliberate." *Valentine v. United States ex rel. Neidecker*, 299 U.S. at 13, 57 S.Ct. at 104.

b. The Failure of the United States to Clarify the Language of Article XV Before the Treaty Went Into Effect. It is not entirely clear when the United States first became aware of the error it now claims is part of Article XV of the Implementation Agreement. The record does reveal that two weeks after the treaty documents were first signed, there were written communications within the government noting the need to clarify the issue. Memorandum from Marcia Field to Richard Goodman (Sept. 21, 1977), *reprinted in* Submission Pursuant to the Judge's Order Filed June 6, 1984, at Exhibit E (filed June 11, 1984). Despite this very early notice, the record discloses a remarkable degree of reluctance on the part of the United States to seek a clarification of the Article XV language from Panama. That reluctance casts doubt upon defendant's assertion that the Article XV language was an error rather than a compromise. The court notes at least three opportunities for clarifying the language of Article XV even after it was initially accepted by Panama but long before the treaty documents went into force.

First. Immediately following the Implementation Agreement there is an Agreed Minute consisting of 21 numbered paragraphs (many having several sub- paragraphs) each of which specifically refers to a portion of the Implementation Agreement. Each paragraph and sub-paragraph provides explanatory and clarifying information as to the understanding of the negotiators pertaining to various portions of the Implementation Agreement. *See* S.Exec.Rep. No. 12, at 35. The Minute thus serves as an official negotiating history to clarify or round out terms of the agreement that were thought to be unclear or ambiguous. No paragraph of the Minute refers to Article XV of the Implementation Agreement.

Second. There was an exchange of notes between the representatives of the United States and Panama on September 7, 1977, the date the treaties were signed. This was approximately a month after agreement had been reached on the language of Article XV. The notes dealt with a number of matters not covered by the treaty documents and also supplied clarifications and assurances as to the effect of the various provisions. *See, e.g.*, Exchange of Notes Relating to Postal Services, Sept. 7, 1977, United States-Panama, *reprinted in* S.Exec.Rep. No. 12, at 276 (exchange of notes clarifying operation of Article X of Agreement in Implementation of Article IV).[24] There was no note exchanged pertaining to Article XV of the Implementation Agreement, at that time or since.

Third. During testimony by Herbert J. Hansell, the Department of State's Legal Advisor, before the Foreign Relations Committee, Senator Richard Stone raised a serious question about the meaning of Article XV. Senator Stone cited newspaper reports that Zone residents were interpreting Article XV as exempting them from U.S. income taxes, much as plaintiff now claims. The Senator expressed concern that the matter would spawn litigation and suggested that the language

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[24]An exchange of notes to correct errors or omissions in an executive agreement is entirely consistent with past practice of the United States. *See* 14 M. Whiteman, *Digest of International Law* 134-36 (1970).

be clarified by means of a formal understanding attached to the ratification documents. *Treaty Hearings* Part 1, at 268. Mr. Hansell strongly resisted the suggestion but promised that "we will find a way to avoid this" and Senator Stone dropped the subject. *Id.* at 269.

Senator Stone's suggestion that the meaning of Article XV be clarified by means of an understanding was sensible and consistent with established practice. It is not at all unusual for the Senate to approve a treaty subject to a formal declaration modifying or clarifying its terms. Where the declaration exempts the United States from a portion of the treaty, or changes one of its terms, it is called a reservation. Restatement § 124; Vienna Convention art. 2(1)(d), 63 Am.J.Int'l L. 876. Where the declaration merely sets forth the Senate's interpretation of a basic term of the agreement, without purporting to change it, it is called an understanding. Restatement § 124 comment c; 14 M. Whiteman, *Digest of International Law* 137-38 (1970) [hereinafter cited as Whiteman, *Digest*].

Reservations and understandings are communicated to the other signatory before the formal exchange of ratification documents. If the terms of the reservation or understanding are acceptable, the other party will affirmatively communicate its acceptance or at least will fail to object. The party will then be bound by the treaty as so modified or clarified. Restatement § 124; D.H. Miller, *Reservations to Treaties* 76-80 (1919) [hereinafter cited as Miller, *Reservations*]; 14 Whiteman, *Digest* 138-39. *See generally* Bishop, 103 Receuil de Cours 266-302. This principle was recognized by the Supreme Court as established over a century and a quarter ago:

> [I]t is too plain for argument that where one of the parties to a treaty, at the time of its ratification annexes a written declaration explaining ambiguous language in the instrument or adding a new and distinct stipulation, and the treaty is afterwards ratified by the other party with the declaration attached to it, and the ratifications duly exchanged—the declaration thus annexed is a part of the

> treaty and as binding and obligatory as if it were inserted in the body of the instrument.

Doe v. Braden, 57 U.S. (16 How.) 635, 656, 14 L.Ed. 1090 (1853).[25] Only if the other signatory objects to the proposed reservation or understanding will the parties have to resolve their differences by further negotiation. However, to be effective,

> [t]he declaration must be *communicated* to the other Party . . . to the treaty. This is obviously necessary, for a treaty is an agreement, and failure to communicate such a declaration would deprive it of any international effect.

Miller, *Reservations* 77 (emphasis original).[26]

If both sides intended that Article XV exempt employees of the Commission only from Panamanian taxes, following Senator Stone's suggestion would have clarified the issue once and for all. The Senate in fact considered a number of reservations and understandings to the treaty package and passed no fewer than 21 of them. *Senate Debate on the Panama Canal Treaties* 411-13, 493-96. Each of these was accepted by Panama and became part of the treaty package without the need for reopening negotiations. *Id.* at 549-52, 557-59. Prudence, candor to our negotiating partner and fairness to the American public, which would have to bear the cost of clarifying the issue through

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[25]The practice of attaching reservations to treaties dates back at least to 1795 when the Senate gave its advice and consent to ratification of the Treaty of Amity, Commerce and Navigation between the United States and Great Britain (commonly known as the Jay Treaty), subject to certain conditions. 8 Stat. 116, T.S. No. 105. One commentator estimated that between 1800 and 1929 the Senate had introduced reservations into at least 66 bilateral treaties. Owen, *Reservations to Multilateral Treaties*, 38 Yale L.J. 1086, 1091 (1929).

[26]In *Sullivan v. Kidd*, 254 U.S. 433, 442, 41 S.Ct. 158, 161, 65 L.Ed. 344 (1921), the Court rejected the argument that a treaty with Britain ought to be interpreted in accordance with the intention of the British negotiators because it found no evidence that their position had been made known to the United States.

litigation,[27] all strongly supported Senator Stone's suggestion that the language of Article XV be clarified through a formal understanding.

The United States argues that such an understanding would have been superfluous because the language of Article XV is clear, because taxation of U.S. citizens is purely an internal matter and because Panama could have no legitimate interest in how the United States construes this language. As discussed above, these assertions are subject to significant doubt. Nevertheless, even if one were to assume that the United States was fully justified in its views, the refusal to confront Panama and seek its concurrence is so striking a departure from the practice of the United States in the field of public international law as to give one serious pause.

Even the most cursory review of how the United States has conducted itself in this delicate area reveals unflagging adherence to the principle that potential disagreements, even of the most remote kind, are resolved through concurrence of the signatory parties, preferably before the treaty goes into force. *Doe v. Braden*, 57 U.S. (16 How.) 635, 14 L.Ed. 1090 illustrates this point. The case involved a treaty whereby Spain ceded certain territories to the United States. The treaty was signed by the President and approved by the Senate. However, before ratification instruments could be exchanged, our government learned of a claim to the territory by a third party. *Id.* at 655. Although the Secretary of State was satisfied that this claim was entirely without merit, he "deemed it his duty to place the matter beyond all controversy before the ratifications were exchanged." *Id.* The United States therefore insisted on the inclusion in the treaty documents of a written declaration expressing "the positive understanding of the negotiators on both sides" that the claim in question had been annulled. *Id.* The

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[27] At least 42 lawsuits, involving perhaps hundreds of plaintiffs, have presented the issue to this and other courts. *See* n. 9 *supra*. The cost borne by the plaintiffs, the defendant and the judicial system in resolving this issue through piecemeal litigation has been, and will continue to be, substantial.

treaty then had to be resubmitted to the Senate and only then were ratification instruments exchanged, bringing the treaty into force.

Our Department of State has, moreover, consistently taken the position that one signatory to an international agreement cannot unilaterally determine what is and what is not of significance to the other signatory. Even matters that are merely of a clarifying nature, or which purport to confirm the view of the negotiators, must be formally presented if they are to become part of the treaty. This position is perhaps best expressed in advice given to Congress by a representative of the Department of State:

> He [Mr. Beverage] asked what kind of reservation would not require renegotiation of a treaty. I emphasized that it was impossible to define such a reservation because each other country concerned has the right to decide whether or not a particular reservation modifies the text or would affect its interests in the application of the treaty. In reply to his statement that he had in mind a reservation which merely clarified the intention of the negotiators, I said that, nevertheless, the other countries concerned would still be entitled to their views with respect to the effect of the reservation.

Office of the Legal Adviser, Treaty Branch (Bevans), "Reservations to treaties," memorandum of conversation with Mr. Beverage of Senator Langer's office, July 20, 1949, MS. Department of State, file 711.00/7-2049, *quoted in* 14 Whiteman, *Digest* 140.

Much thought has also been given to whether matters that are of purely domestic concern to one of the negotiating parties must be presented for the approval of the other party. The advice given by the State Department again clarifies the position of the United States:

> He also inquired as to whether a simple reservation relating to "a purely domestic matter", such as "one re-

> quiring approval by two-thirds of the Senators of any arms assistance", would have to be approved by other countries. I explained that while the reservation may be considered by the United States as relating to a purely domestic matter, the fact that our ratification is given subject to a reservation would give the other countries concerned the right to consider whether or not the reservation affected our international obligations under that treaty or would affect the application of the treaty in our relations with other countries.

Id.

The position traditionally taken by the United States is so intuitively correct that it requires little elucidation. The fact is that even exercising the utmost good faith, one country simply cannot take into account all of the interests, points of view, political and social factors, perceived advantages and disadvantages, realities and appearances, and other considerations that define another country's self-interest. As an equal sovereign, each country is entitled to make up its mind as to whether a particular provision of a treaty, or a reservation or understanding attached thereto, does or does not affect its interests. It has been traditional, therefore, for our government to inform its negotiating partners of even those matters that it believes are of no consequence to them, and to allow them an opportunity to assent or object. *See, e.g., Power Authority of New York v. Federal Power Commission*, 247 F.2d 538 (D.C.Cir.), *vacated as moot sub nom., American Public Power Association v. Power Authority of New York*, 355 U.S. 64, 78 S.Ct. 141, 2 L.Ed.2d 107 (1957).

The *Power Authority of New York* case involved a treaty with Canada concerning use of the water of the Niagara River. In ratifying the treaty, the Senate attached a stipulation that reserved to the United States the right "to provide by Act of Congress for redevelopment, for the public use and benefit, of the United States share of the waters" made available through the treaty. *Id.* at 539. Our Department of State advised the

Canadian Government of this "reservation" but took the position that this was a purely internal matter, of no interest to Canada. Canada responded by diplomatic note, accepting the position of the United States that this was a matter relating "only to the internal application of the Treaty within the United States (that did) not affect Canada's rights or obligations under the Treaty." *Id.* at 541. The court relied upon this disclaimer in determining that the reservation was not a matter of interest to Canada, and therefore effectively not a part of the treaty. *Id.*[28]

These principles have been applied so uniformly by our State Department in dealings with other governments, and by other governments in their dealings with us, that they can fairly be characterized as reflecting the universally accepted practice in the area of international law. *See generally* 14 Whiteman, Digest 137-93; 5 G. Hackworth, *Digest of International Law* 93-153 (1943) [hereinafter cited as Hackworth, *Digest*]. Indeed, a memorandum prepared by the State Department and transmitted to the United Nations stated the proposition as follows:

> Even in the case of an "understanding" . . . it is the *invariable rule* in regard to bilateral treaties to obtain the consent of the other country before ratifying the treaty.

U.S. Department of State, *The Law of Treaties as Applied by The Government of the United States of America* 102 (Mar. 31,

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[28] Additional examples of this practice are abundant. For example, in giving its advice and consent to the treaty establishing friendly relations with Austria signed on August 24, 1921, the Senate included a series of understandings dealing with matters of U.S. domestic law. Prior to the exchange of ratification instruments, Secretary of State Hughes wrote to Austria and advised that these understandings "of course relate merely to matters of domestic policy and procedure, which are of no concern to the Austrian Government." Letter from Secretary of State Hughes to Commissioner Frazier of Austria (Oct. 24, 1921), MS. Department of State file 711.63119/22b, *quoted in* 5 G. Hackworth, *Digest of International Law* 120-21 (1943). The Austrians were satisfied with this explanation and approved the exchange of ratification documents. Letter from Commissioner Frazier to Secretary of State Hughes (Nov. 8, 1921), MS. Department of State file 711.63119/26, *cited in* 5 Hackworth, *Digest* at 121.

1950), *quoted in* Bishop, 103 Receuil des Cours 304 (emphasis added).[29] The failure of our government to comply with this established practice throughout the treaty ratification process, despite serious questions on the proper construction of Article XV raised by Congress, the press and within the Executive Branch itself, diminishes further the deference that the court can accord defendant's interpretation of the language in question.

Over half a century ago Charles Evans Hughes wrote the following in response to a Senate inquiry as to the types of reservations or understandings that might properly be attached to the ratification of the Treaty of Versailles:

> Statements to safeguard our interest which clarify ambiguous clauses in the covenant by setting forth our interpretation of them, and especially when the interpretation is one which is urged by the advocates of the covenant to induce support, can meet with no reasonable objection. It is not to be supposed that such interpretations will be opposed by other parties to the treaty, and they will tend to avoid disputes in the future.

58 Cong.Rec. 3302 (1919). The interpretation of Article XV offered by our Department of State to the Senate can fairly be

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[29]Marjorie Whiteman, Assistant Legal Adviser to the United States Department of State, expressed the same view in almost identical terms:

> A statement designated as a "reservation" or "reservation and understanding" contained in an instrument of ratification of a treaty may be regarded as nothing more than a clarifying statement or declaration short of a reservation if it does not, in fact, constitute a qualification or modification of the substantive terms of the treaty. Nevertheless, in the case of a bilateral treaty *it is the invariable practice*, prior to the making of arrangements for the exchange of ratifications and sometimes even prior to ratification of the treaty, *for the government making the statement or declaration to notify the other government thereof in order that the latter may have an opportunity to accept, reject, or otherwise express its views with respect thereto.*

14 Whiteman, *Digest* 188-89 (emphasis added). The *Digest* catalogues and generally reflects the official position of the United States on questions of international law.

characterized as "urged by the advocates of the covenant to induce support." If the defendant is correct that it concerns a purely internal matter of no consequence to Panama, then "it is not to be supposed that such interpretation[ ] [would have been] opposed by [the] other part[y] to the treaty." Under such circumstances, the clarification of the meaning of Article XV by means of an understanding, as suggested by Senator Stone, a diplomatic note, or some other means that secured concurrence from Panama on this simple point "[could] meet with no reasonable objection . . . [and would have tended] to avoid disputes in the future." Since defendant has offered no satisfactory explanation for its failure to follow established practice in this sensitive area, the court must infer that officials of the Department of State who were familiar with the treaty negotiations (and had access to the then classified negotiating transcripts) feared that Panama would refuse to concur in their interpretation of Article XV and for that reason refused to seek its consent.

c. Additional Considerations.

A number of other factors, each of them perhaps less weighty than the foregoing, conspire to further undermine the deference the court is able to afford the interpretation offered by the United States. It is worth mention, for example, that in this case the United States is a litigant—a party with a financial interest in the outcome of the proceedings. In such circumstances it is appropriate to scrutinize its position more closely than where it is participating as amicus curiae, its only interest being the proper conduct of our foreign relations and the correct interpretation of our laws. *See, e.g., Sumitomo Shoji*, 457 U.S. 176, 102 S.Ct. 2374, 72 L.Ed.2d 765; *Kolovrat*, 366 U.S. 187, 81 S.Ct. 922, 6 L.Ed.2d 218.

Moreover, this case is not like *Factor v. Laubenheimer*, 290 U.S. at 295, 54 S.Ct. at 196, or *Great-West Life Assurance Co.*, 678 F.2d 180, 230 Ct.Cl. at 491, where the construction offered by the United States had remained unchallenged for decades and therefore was entitled to deference by virtue of its longevi-

ty and consistency. *Cf. Consumer Products Safety Commission v. GTE Sylvania*, 447 U.S. 102, 120, 100 S.Ct. 2051, 2062, 64 L.Ed.2d 766 (1980) (lack of longstanding contemporaneous administrative construction of statute undermines degree of deference to be afforded agency's interpretation). Here, the controversy over what this language means arose within days of its initial adoption, in ample time for the United States to obtain a correction or clarification before the ratification process was completed. Nor is the language of Article XV so complex, or its subject matter so specialized, that deference to administrative expertise is of particular relevance. *Cf. Great-West Life Assurance Co.*, 678 F.2d 180, 230 Ct.Cl. at 481.

Finally, defendant has offered no factual basis supporting a significant degree of administrative deference. Indeed, it appears that the interpretation of Article XV proffered by the United States consists of little more than the best hopes of State Department officials, many of whom had no direct involvement in the negotiation of this provision. The letter transmitting the section-by-section analyses to the Senate states that they were prepared "by members of the treaty negotiating team and have been approved by the offices of the State and Defense Departments directly involved in the negotiations." S.Exec.Rep. No. 12, at 127. It is interesting to note, however, that there is no evidence that anyone involved with the actual negotiation of Article XV of the Implementation Agreement drafted or reviewed these analyses. In response to a discovery request, defendant admitted that the analyses were prepared after the negotiations had been completed and after the treaty documents had been signed. Defendant's Response to Plaintiff's Second Request for Admissions at 2 (Nos. 21 and 22) (filed June 11, 1984). Moreover, defendant disclosed that the analyses were drafted by two individuals, Michael Kozak and Geraldine Chester, who were not present at any of the negotiating sessions during which we know that the substance of Article XV was discussed. *Id.* (No. 22b(A)) (Mr. Kozak and Ms. Chester were present at the July 18, 1977, negotiating session where there appears to have been some general discussion of

the Implementation Agreement but not of Article XV or the subject of taxation.) Defendant admits that it does not know who was present when the Article XV language was proposed or discussed. Defendant's Response to Plaintiffs' Interrogatories at 3 (No. 10) (filed June 11, 1984). There is no evidence, therefore, that the supposedly authoritative interpretations of the language proffered by the United States were ever reviewed or approved by those who were involved in face-to-face negotiations with Panama on the subject.

3. The Legislative History

Defendant suggests that the Senate consented to the ratification of the Panama Canal Treaty with the understanding that Article XV of the Implementation Agreement exempted Commission employees only from Panamanian taxation and not from United States taxation. Defendant cites in support of its proposition the colloquy between Senator Stone and the State Department's Legal Adviser, Mr. Hansell, *see* p. 138 *supra*, and the Report of the Senate Foreign Relations Committee, which incorporated the State Department's section-by-section analysis.

Even in the case of purely domestic legislation, "[r]eliance on legislative history in divining the intent of Congress is . . . a step to be taken cautiously." *Piper v. Chris-Craft Industries, Inc.*, 430 U.S. 1, 26, 97 S.Ct. 926, 941, 51 L.Ed.2d 124 (1977); *see Hart v. United States*, 585 F.2d 1025, 218 Ct.Cl. 212, 221-31 (1978). That caution must be even greater where the document in question grows out of sensitive negotiations with a foreign government whose intentions and views can only be expressed through treaty language and other documents attached to the ratification process.

It should first be noted that the legislative history cited by defendant is not as compelling as it would have the court believe. The most one can say about the conversation between Senator Stone and Mr. Hansell is that one member of the Senate Foreign Relations Committee may have been persuaded by the position taken by the Executive Branch; there is

no indication that any other members of the Committee shared those views. "[O]rdinarily even the contemporaneous remarks of a single legislator . . . are not controlling in analyzing legislative history." *Consumer Products Safety Commission*, 447 U.S. at 118, 100 S.Ct. at 2061. The Committee Report merely recites the interpretation offered by the State Department without elaboration or discussion. Of course, there was no reason the Committee should have questioned the interpretation offered by the Executive Branch. The issue, on its face, appeared to be merely one of domestic tax law; the negotiating transcripts, which place the matter in a wholly different light, were still classified and there is no indication that they were presented to or examined by the Committee.

In any case, all three branches of our government have taken the position that even the clearest expression of legislative intent cannot change the legal effect of an international agreement to which the Senate has given its approval. In *Fourteen Diamond Rings v. United States*, 183 U.S. 176, 179-80, 22 S.Ct. 59, 60-61, 46 L.Ed. 138 (1901), the Court held that a Senate Resolution that had not been brought to the attention of Spain, the other signatory to the treaty, was "absolutely without legal significance." Charles Evans Hughes, in his letter to the Senate in 1919, considered this proposition as black letter law: "The adoption of resolutions by the Senate setting forth its views will not affect the obligations of the covenant if it is in fact ratified without reservations which constitute part of the instrument of ratification." 58 Cong.Rec. 3302 (1919).

The Senate thoroughly considered the same issue during the deliberations over the Kellogg-Briand Peace Treaty of August 27, 1928. *See* 70 Cong.Rec. 1655 *et seq.* (1929). After considerable debate, the Senate concluded that a legislative report not mentioned or included in the resolution of ratification could not modify or amend the treaty in any way. *See id.* at 1730. This view was accepted by the Department of State and related to other signatories of the treaty. Telegram from Secretary of State Kellogg to Ambassador to Great Britain (Jan. 17, 1929) & Telegram from Secretary Kellogg to Ambassador to France (Jan. 18, 1929), *cited in* 5 Hackworth, *Digest* 153.

The State Department has consistently taken this view. For example, on May 24, 1907, Secretary of State Root wrote Dominican Republic Minister Joubert concerning the effect of a resolution adopted by the Dominican Congress in approving a convention with the United States. Secretary Root requested that the resolution—which explained the Dominican Congress' interpretation of the convention—not be included in the instrument of ratification because to do so might change the legal effect of the treaty, making it impossible for our President to accept the ratification. On the other hand, Secretary Root took the position that if the legislative report was not attached to the ratification documents, it could have no legal effect on the relationship between the parties, even though the United States was fully aware of it. Letter from Secretary of State Root to Dominican Minister Joubert (May 24, 1907), *cited in* 5 Hackworth, *Digest* 125-26.

There are important policies behind the refusal to give legal effect to expressions of intent that are not contained in the ratification documents and thereby made part of the formal agreement between the parties. Unless such statements are included in the ratification instruments, it is impossible to determine whether the confirming body (here the Senate) assented to the proposed interpretations. *See Fourteen Diamond Rings*, 183 U.S. at 180, 22 S.Ct. at 61. Here, for example, the Committee Report, which reflects the State Department's section-by-section analyses, was voted upon by the members of the Foreign Relations Committee but not by the full Senate. Even if one were persuaded that the Foreign Relations Committee accepted all of the State Department's analyses, there is no assurance that two-thirds of the full Senate would have. As the Court of Claims cautioned in *Hart*, "[t]o legislate by committee report would raise a [serious] constitutional problem." 585 F.2d 1025, 218 Ct.Cl. at 222. In addition, where the document is not part of the ratification protocol, there is no assurance that the President has given his approval to it. *See New York Indians v. United States*, 170 U.S. 1, 23, 18 S.Ct. 531, 536, 42 L.Ed. 927 (1897).

Perhaps most important, foreign governments dealing with us must rely upon the official instruments of ratification as an expression of the full intent of the government of the United States, precisely as we expect from foreign governments. The Supreme Court confronted this very issue in *New York Indians* where the United States relied upon a provision in the resolution of ratification not included in the President's proclamation ratifying the treaty. The Court held the resolution to be of no effect, stating as follows:

> There is something . . . which shocks the conscience in the idea that a treaty can be put forth as embodying the terms of an arrangement with a foreign power or an Indian tribe, a material provision of which is unknown to one of the contracting parties, and is kept in the background to be used by the other only when the exigencies of a particular case may demand it.

Id. More recently, Professor Bishop stated the same proposition in more general terms:

> The fundamental basis remains, that no state is bound in international law without its consent to the treaty. This is the starting point for the law of treaties, and likewise for our international law rules dealing with reservations.

Bishop, 103 Receuil des Cours 255.

The Senate managed to attach a multitude of reservations, understandings and other modifications to the treaties with Panama as a condition for giving its advice and consent. Each of those instruments was approved by two-thirds of the Senate, presented by the President and accepted by Panama. It would be entirely inappropriate—and inconsistent with the established policy of the United States—to now modify the agreement on the basis of views expressed in committee and never approved by the Senate or presented to Panama for its concurrence or rejection. *See New York Indians*, 170 U.S. at 22-23, 18 S.Ct. at 536.

In sum, nothing presented by defendant supports the finding that Panama and the United States "intended to agree on

something different from that appearing on the face of" Article XV of the Implementation Agreement. "Without such a finding the agreement must be interpreted according to its unambiguous language." *Choctaw Nation*, 318 U.S. at 432, 63 S.Ct. at 678.

C.
ADDITIONAL CONSIDERATIONS

The preceding section of the opinion was premised on the court's conclusion that the language of Article XV is clear and unambiguous. Even if one were to take the position that the language of Article XV is ambiguous, there is, nevertheless, much reason to resolve the ambiguity in favor of the interpretation offered by plaintiff.

1. The Failure of the United States to Present Evidence of Panama's Intent

Even under the best of circumstances, it is very difficult for the court of one signatory state to understand and appreciate the intentions, interests and motivations of another signatory state. For one thing, states are not always of a single mind; different officials or agencies may hold different views as to what is in the state's interest.[30] It is therefore important to obtain the *official* position of the government in question. Then again, governments are known to change their official position as to how a treaty ought to be interpreted. For example, in

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[30]*Sumitomo Shoji* provides an example of this. In that case, the United States presented an interpretation of the disputed treaty provision from Japan's Ministry of Foreign Affairs (MFA). Brief for the United States as Amicus Curiae at 19-20 & n. 11, *Sumitomo Shoji America, Inc. v. Avagliano*, 457 U.S. 176, 102 S.Ct. 2374, 72 L.Ed.2d 765 (1982). The interpretation offered by MFA supported the respondents in that case. At the same time, Japan's Ministry of International Trade and Industry (MITI) filed an amicus curiae brief which presented a position that "might be understood to support [petitioner's] position on this issue." *Id.* at 20 n. 11. The United States requested that the Supreme Court accept MFA's position because "MFA is the Office of the Government of Japan responsible for interpretation of the Treaty." *Id.*

Sumitomo Shoji, the Department of State initially interpreted the treaty in a manner that supported petitioner; later, it interpreted the treaty consistent with the view offered by respondents. The Supreme Court was not troubled by this lack of consistency. It accepted the official interpretation presented at the time the case was pending for decision. 457 U.S. at 184 n. 9, 102 S.Ct. at 2379 n. 9.

As has been noted, there is little doubt as to the interpretation our government places on Article XV of the Implementation Agreement. However, the record is devoid of any statement of the official Panamanian position. The court has discussed at length the possibilities for obtaining a clarification of the language in question before the treaty was ratified. *See* pp. 137-142 supra. In addition, there has been ample opportunity for the United States to obtain Panamanian concurrence for its views even *after* the treaty went into effect.

One method would have been through the administrative mechanism established by the Implementation Agreement itself. Article II of the agreement provides for the establishment of a Coordinating Committee composed of representatives of the United States and Panama. Paragraph 4 of Article XV authorizes the Coordinating Committee to "establish such regulations as may be appropriate for the implementation of this Article." The Coordinating Committee was in fact established. Agreement Establishing Coordinating Committee, Oct. 1, 1979, United States-Panama, T.I.A.S. No. 10044. Its charter covers a broad array of functions, largely in resolving points of friction that might arise under the Implementation Agreement. The Coordinating Committee has been in operation for about four years but has not issued any regulations pertaining to taxation. Letter from John L. Haines, Jr., Deputy United States Representative to the Coordinating Committee, to Patricia M. McDermott, Librarian, United States Court of Appeals for the Federal Circuit (June 1, 1984) (filed June 12, 1984).

Issuance of regulations that support defendant's position would have been an effective and time-honored method for

clarifying language in the Implementation Agreement that the United States claims is ambiguous. Of course, promulgation of any such regulations would require the concurrence of the Panamanian member of the Coordinating Committee. However, if defendant is correct in its assertion that paragraph 2 of Article XV was meant to exempt Commission employees only from Panamanian taxes, such concurrence should not have been difficult to secure. Nevertheless, defendant has failed to avail itself of this opportunity to clarify the language of the Implementation Agreement.

In addition, defendant might have obtained a diplomatic note or other official indication from Panama as to its view of this matter. Indeed, after expressing considerable skepticism as to defendant's position, Feb. 23 Transcript at 52, 65-66, the court recessed for two weeks to give defendant an opportunity to consider supplementing the record by obtaining an indication from Panama as to its intentions in agreeing to the language of Article XV. At the next hearing on the matter, defense counsel informed the court that no clarification would be requested or obtained from Panama. Mar. 8 Transcript at 3, 8. The court then took the unusual step of inviting an appearance by a more senior attorney to ensure that the implications of this decision were fully understood and appreciated by defendant. Defense counsel and her supervisor appeared at a hearing later the same day and the court once again stated that it found plaintiff's presentation persuasive but urged defendant to supplement the record by obtaining clarification from Panama or through some other means. Id. at 26-27, 39-40, 43-45, 49-50. Despite numerous statements by the court that it would decide the case in favor of plaintiff on the record as presented, defendant steadfastly refused the opportunity to supplement the record.

The notion that defendant can obtain clarifying statements as to the meaning of treaty language while a case is in litigation did not originate with this court. From time to time, our government has used diplomatic channels to obtain the concurrence of its negotiating partner where ambiguous treaty

language has been the subject of litigation. The most recent example of which the court is aware occurred in *Sumitomo Shoji*, 457 U.S. 176, 102 S.Ct. 2374, 72 L.Ed.2d 765. That case involved a suit by female employees against the New York subsidiary of a Japanese trading company; plaintiffs claimed that the company discriminated in favor of Japanese males in promotions to executive positions. Resolution of the dispute turned on interpretation of ambiguous language in a treaty between the United States and Japan. The United States appeared as amicus curiae while the case was pending before the Supreme Court. As part of its presentation, it referred to a cable from the Japanese Ministry of Foreign Affairs to the United States Embassy in Tokyo. The cable gave an interpretation of the treaty that was consistent with the interpretation of our government. *Id.* at 183-84 & n. 10, 102 S.Ct. at 2378-79 & n. 10. The Supreme Court obviously was impressed by the submission and relied upon it. *Id.* Similarly, in *Kolovrat*, the Supreme Court was swayed by an exchange of notes between our government and Yugoslavia's "to the effect that the 1881 Treaty, now and always, has been construed" in the manner suggested by the United States. 366 U.S. at 194, 81 S.Ct. at 926.

Obtaining a diplomatic note interpreting an ambiguous treaty provision makes sense because, after all, the court must divine the intent of *both* parties to the agreement. Of course, it would be entirely plausible for defendant to take the position that such clarifications will not be sought because the practice might unduly burden our relations with other countries.[31] De-

[31]The court has been exceedingly careful to give appropriate deference to the political branches of our government on matters involving foreign affairs. *See, e.g., Langenegger v. United States*, 5 Cl.Ct. 229 (1984), *appeal docketed*, No. 84-1420 (Fed.Cir. July 10, 1984); *Shanghai Power Co. v. United States*, 4 Cl.Ct. 237 (1983), *appeal docketed*, No. 84-860 (Fed.Cir. Feb. 28, 1984). Even in this case, the court has examined a number of documents on an ex parte, in camera basis to avoid publication of classified material. *See* p. 131 & n. 15 *supra*. However, defendant raised *no* suggestion, however veiled, that approaching Panama on this issue would have adverse foreign policy implications. Indeed, defense counsel represented that she had not even discussed the court's suggestion with representatives of the Department of State. Mar. 8 Transcript at 8.

fendant has not, however, taken this position. In fact, it appears perfectly willing and able to obtain such clarifications when it believes it advantageous to do so.

It is quite clear from the repeated exchanges on this point between the court and counsel that the decision not to seek clarification from Panama was based exclusively upon counsel's assessment of the litigation risks. *See, e.g.*, Mar. 8 Transcript at 44, 49-50. Under these circumstances, the court must draw a negative inference from defendant's refusal to "produc[e] evidence peculiarly within its possession." *Paccon, Inc. v. United States*, 399 F.2d 162, 185 Ct.Cl. 24, 40 (1968); *accord Borror v. Herz*, 666 F.2d 569, 573-74 (C.C.P.A.1981); *California-Pacific Utilities Co. v. United States*, 194 Ct.Cl. 703, 718 (1971).[32] The negative inference means, at the very least, that any ambiguity in the language of Article XV must be construed against defendant.

2. Established Principles of Treaty Construction

Courts are naturally reluctant to give treaties a construction contrary to that proffered by the Executive Branch, although they will do so from time to time. *See, e.g., Johnson v. Browne*, 205 U.S. 309, 27 S.Ct. 539, 51 L.Ed. 816 (1907); *New York Indians*, 170 U.S. 1, 18 S.Ct. 531, 42 L.Ed. 927. However, the step is never to be taken lightly or without careful consideration of the arguments offered by the United States in support of its position. Yet, the court must also be mindful of the fact that it has special responsibilities in interpreting an international agreement. Aside from its normal duty to uphold the law as written, the court must also safeguard the dignity and credibility of our nation in its dealings with other sovereigns. As the Supreme Court noted a century ago:

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[32]Of course, defendant alone is in a position to solicit and present the official view of Panama. Plaintiff has already done more than can be expected in this regard. *See* p. 131 & n. 16 supra. Any further efforts by plaintiff might run afoul of U.S. law. *See* 18 U.S.C. § 953 (1982).

> Aside from the duty imposed by the Constitution to respect treaty stipulations when they become the subject of judicial proceedings, the court cannot be unmindful of the fact, that the honor of the government and people of the United States is involved in every inquiry whether rights secured by such stipulations shall be recognized and protected.

Chew Heong v. United States, 112 U.S. 536, 540, 5 S.Ct. 255, 256, 28 L.Ed. 770 (1884). The Court has therefore urged again and again that treaties be interpreted in a spirit of "*uberrima fides*," that is, with the most scrupulous good faith. Tucker v. Alexandroff, 183 U.S. 424, 437, 22 S.Ct. 195, 200, 46 L.Ed. 264 (1902). More specifically, the Court stated:

> As treaties are solemn engagements entered into between independent nations for the common advancement of their interests and the interests of civilization, and as their main object is not only to avoid war and secure a lasting and perpetual peace, but to promote a friendly feeling between the people of the two countries, they should be interpreted in that broad and liberal spirit which is calculated to make for the existence of a perpetual amity, so far as it can be done without the sacrifice of individual rights or other principles of personal liberty which lie at the foundation of our jurisprudence.

Id.; *accord Santovincenzo*, 284 U.S. at 40, 52 S.Ct. at 84; *Jordan v. Tashiro*, 278 U.S. at 127; see Vienna Convention art. 26, 63 Am.J.Int'l L. 884 ("[e]very treaty in force is binding upon the parties to it and must be performed by them in good faith"). In addition, the Court has noted that "[w]hen a treaty provision fairly admits of two constructions, one restricting, the other enlarging rights which may be claimed under it, the more liberal interpretation is to be preferred." *Nielsen v. Johnson*, 279 U.S. 47, 52, 49 S.Ct. 223, 224, 73 L.Ed. 607 (1929); *accord Bacardi Corp. v. Domenech*, 311 U.S. 150, 163, 61 S.Ct. 219, 226, 85 L.Ed. 98 (1940); *Jordan v. Tashiro*, 278 U.S. at 127, 49

S.Ct. at 48; *Geofroy v. Riggs*, 133 U.S. at 271-72, 10 S.Ct. at 298-99.[33]

Even if defendant was under the impression that the provision only limits Panama's right to tax Commission employees, it must be remembered that it was the United States that proffered the language in question to Panama. Any ambiguity in the language must therefore be construed against the United States unless there is convincing evidence showing that both parties interpreted the provision in the same manner. Restatement (Second) of Contracts § 206 (1979).[34] As previously noted, no such evidence exists. Moreover, the United States appears to have had notice of the ambiguity at a very early stage in the process, long before the agreement went into effect. Its failure to alert its negotiating partner of the problem and to obtain a clarification means that the language should be construed as Panama would read it.[35] The court's responsibility to act in good faith toward nations that enter into treaties with the United States requires no less.

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[33]In this case, the construction urged by plaintiff is further supported by the rule that laws affecting taxation must be construed strictly in favor of the taxpayer. *Crooks v. Harrelson*, 282 U.S. 55, 61, 51 S.Ct. 49, 51, 75 L.Ed. 156 (1930); *Estate of Renick v. United States*, 687 F.2d 317, 231 Ct.Cl. 457, 463 (1982).

[34]While this rule of construction is most frequently applied to contracts between private parties, it is equally applicable where the contracting parties are sovereign states. *See, e.g.*, Opinion of Umpire Parker, Mixed Claims Commission, *The Lusitania Cases (United States v. Germany)*, Decisions and Opinions 17, 31, *quoted in* 5 Hackworth, *Digest* 230. *See also* 5 Hackworth, Digest 234.

[35]One Commentator has noted as follows:

> The performance of treaties is subject to an overriding obligation of mutual good faith. This obligation is also operative in the sphere of the interpretation of treaties, and it would be a breach of this obligation for a party to make use of an ambiguity in order to put forward an interpretation which it was known to the negotiators of the treaty not to be the intention of the parties.

A. McNair, *The Law of Treaties* 465 (1961).

CONCLUSION

The question presented in this case is not whether the Implementation Agreement (or indeed the Panama Canal Treaty package as a whole) is a wise policy; policy must be left to the political branches of our government. Nor is the question whether the agreement signed with Panama is a good deal for the United States; striking bargains with other nations is the prerogative of the President. The only issues presented here are whether the President was acting within the scope of his authority when he signed the Implementation Agreement and, if so, whether the agreement means what it says. For the reasons discussed above, both questions must be answered in the affirmative.

Plaintiff's motion for summary judgment is granted. Defendant's motion for summary judgment is denied.

The clerk is directed to file a copy of this opinion in each of the cases that has been suspended pending final resolution of this case.

APPENDIX C

UNITED STATES COURT OF APPEALS
FOR THE FEDERAL CIRCUIT

PAUL H. & PATRICIA COPLIN,
Appellees,
v. **No. 85-504 Your No. 517-81T**
THE UNITED STATES,
Appellant.

ROBERT E. O'CONNOR, *et ux.*
GLADYS E. O'CONNOR,
Appellees,
v. **No. 85-505 Your No. 265-84T**
THE UNITED STATES,
Appellant.

JON D. COFFIN,
Appellee,
v. **No. 85-506 Your No. 223-83T**
THE UNITED STATES,
Appellant.

JACK R. & MARIA R. MATTOX,
Appellees,
v. **No. 85-507 Your No. 717-83T**
THE UNITED STATES,
Appellant.

JUDGMENT

ON APPEAL from the United States Claims Court

This CAUSE having been heard and considered, it is

ORDERED and ADJUDGED: REVERSED, and direct that summary judgment be granted in favor of the appellant.

DATED May 10, 1985
The Three Appellees Petitions for Rehearing, Denied, July 3, 1985.

ENTERED BY ORDER OF THE COURT
George E. Hutchinson, Clerk

_____
Clerk

ISSUED AS A MANDATE: JUL 12 1985

APPENDIX D

UNITED STATES COURT OF APPEALS,
ELEVENTH CIRCUIT.

AUG. 14, 1985.

No. 84-8424.

RALPH D. HARRIS AND JOAN F. HARRIS,
Plaintiffs-Appellees,

V.

UNITED STATES OF AMERICA,
Defendant-Appellant.

On cross motions for summary judgment in action for refund of federal income taxes, the United States District Court for the Southern District of Georgia, Dudley H. Bowen, Jr., J., 585 F.Supp. 862, granted plaintiffs' motion and denied defendant's motion, and defendant appealed. The Court of Appeals, Eugene A. Wright, Circuit Judge, sitting by designation, held that clear language of Panama Canal treaty creates binational tax exemption for Panama Canal Commission employees.

Affirmed.

Appeal from the United States District Court for the Southern District of Georgia.

Before KRAVITCH, CLARK and WRIGHT*, Circuit Judges.

EUGENE A. WRIGHT, Circuit Judge

During 1979, Ralph and Joan Harris resided in the territory within the Republic of Panama that formerly constituted the Canal Zone. They worked for and received a salary from the

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*Honorable Eugene A. Wright, U.S. Circuit Judge for the Ninth Circuit sitting by designation.

Panama Canal Commission (PCC). They filed a joint federal income tax return and paid taxes allegedly due. In 1980, the Harrises filed a refund claim for excess taxes of $6,647 paid in 1979. The claim constituted taxes assessed on wages earned from the PCC from October 1 to December 31, 1979. The Internal Revenue Service (IRS) disallowed the claim.

The basis for taxpayers' refund claim is Article XV of the Agreement in Implementation of Article III of the Panama Canal Treaty (Agreement). Taxpayers assert it exempts U.S. citizens from taxation of income derived from their PCC employment. The government construes the Agreement as allowing an exemption only from Panamanian taxation.

The Harrises initiated this civil lawsuit in the district court for the Southern District of Georgia, where they then resided. On cross-motions for summary judgment, the court granted the plaintiffs' motion and entered judgment against the government for the amount sought, plus interest. 585 F.Supp. 862 (S.D.Ga.1984). We affirm.

PANAMA CANAL TREATY

Pursuant to Treaty adopted in 1903, the United States constructed the Panama Canal. Isthmian Canal Convention, T.S. No. 431, 33 Stat. 2234 (Nov. 18, 1903). The treaty granted to the United States "the rights, powers and authority . . . which the United States would possess and exercise if it were the sovereign of the territory. . . ." *Id.*, Article III.

On September 7, 1977, the United States and Panama signed a second Panama Canal Treaty, T.I.A.S. No. 10030, which became effective on October 1, 1979. *See* 22 U.S.C. §§ 3601-3871 (West Supp.1985). It restored to Panama territorial sovereignty over the Canal Zone and granted to the U.S. the right to manage, operate and maintain the canal until the year 2000. The PCC is the agency through which the United States manages canal operations. *Id.*, § 3611.

Because sovereignty was being transferred from the U.S. to Panama, it was imperative to define the rights and legal status of PCC employees. Article III, paragraph 9, provides that:

the rights and legal status of the United States Government agencies and employees operating in the Republic of Panama pursuant to this Article, shall be governed by the Agreement in Implementation of this Article, signed this date.

The issue before the court concerns interpretation of paragraph two of Article XV of the Agreement. Article XV, which governs taxation of the PCC, its contractors and subcontractors, and its U.S. citizen employees and their dependents, is quoted in its entirety.

TAXATION

1. By virtue of this Agreement, the Commission, its contractors and subcontractors, are exempt from payment in the Republic of Panama of all taxes, fees or other charges on their activities or property.

2. United States citizen employees and dependents shall be exempt from any taxes, fees, or other charges on income received as a result of their work for the Commission. Similarly, they shall be exempt from payment of taxes, fees or other charges on income derived from sources outside the Republic of Panama.

3. United States citizen employees and dependents shall be exempt from taxes, fees or other charges on gifts or inheritance or on personal property, the presence of which within the territory of the Republic of Panama is due solely to the stay therein of such persons on account of their or their sponsor's work with the Commission.

4. The Coordinating Committee may establish such regulations as may be appropriate for the implementation of this Article.

Historically, U.S. citizens employed by the Canal Zone received favorable tax treatment. Until 1951, income earned by U.S. citizens employed by the Panama Canal Company or the Panama Canal Zone government was totally exempt from

federal income taxation. Beginning in 1951, the income of those persons was taxed by this government at a lower effective tax rate than mainland taxpayers.

MOTIONS TO STRIKE

By motion on October 19, 1984, the appellees moved to strike footnotes 18 and 19 of the government's opening brief alleging lack of foundation, irrelevancy, incompetency and immateriality.[1]

Although the government did not request leave of court to file extra-record materials, it filed a diplomatic note from the Panamanian Government on March 1, 1985. This late filing of extra-record evidence prompted a second motion to strike by appellees. Therein, they challenged the manner in which the diplomatic note was prepared and presented to us.

The government opposed the motions, citing Supreme Court practice in this area of international diplomacy, which calls for supplementing the record with any material that might aid in treaty interpretation.

We shall dispense with the need for a formal order granting the motions.[2] We shall not consider the challenged material and

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[1]Footnote 18 of appellant's brief states:

> We are informed that the Government of the Republic of Panama has never expressed any difference of opinion with respect to the position taken by the United States with respect to the domestic taxation of United States citizens who are employed by the Commission.

Footnote 19 states:

> Significantly, the official Panama Government publication of the texts of the Canal Treaties and related agreements, entitled *Tratados Del Canal de Panama* (1980), indicates that the Republic of Panama shares the United States' view that the exemptions in paragraph 2 of Article XV apply only to Panamanian taxes. The index of that publication (at 313) contains a heading entitled 'IMPUESTOS (Republica de Panama)' (TAXES (Republic of Panama)) and lists thereunder, *inter alia*, 'Exenciones a los empleados ciudadanos de los Estados Unidos y sus dependientes por razon de su trabajo' (Exemptions to the United States citizen employees and their dependents by reason of their work) Ac—III, Art. XV, pars. 2, 3. No mention is made of exemption from United States taxation.

[2]Appellees' request for costs and expenses in bringing their motions is denied.

we reject the government's suggestion that self-serving evidence outside the record, for which additional explanation is required, can be considered by this court.[3] *See United States v. Oakley*, 744 F.2d 1553, 1556 (11th Cir.1984) (per curiam) (appellate court reviewing grant of summary judgment can review only matters presented to the district court); *Mitchell v. Trade Winds Co.*, 289 F.2d 278, 279 (5th Cir.1961) (Labor Dept. files not in evidence before district court rejected on appeal). But *cf. Dickerson v. Alabama*, 667 F.2d 1364, 1367 & n. 5 (11th Cir.) (appellate court has inherent equitable powers to supplement the record to include state court trial transcript in habeas corpus action), *cert. denied*, 459 U.S. 878, 103 S.Ct. 173, 74 L.Ed.2d 142 (1982).

STANDARD OF REVIEW

In reviewing the grant of summary judgment, an appellate court must apply those legal standards that control the district court's determination. *Mercantile Bank & Trust Co., Ltd. v. Fidelity and Deposit Co.*, 750 F.2d 838, 841 (11th Cir.1985); *Environmental Defense Fund v. Marsh*, 651 F.2d 983, 991 (5th Cir.1981). The appellate court may review only matters presented to the trial court. Oakley, 744 F.2d at 1556.

We apply the same rules of treaty interpretation to executive agreements implementing treaty provisions. Clear language controls unless it "'effects a result inconsistent with the intent or expectations of its signatories.'" *See Sumitomo Shoji America, Inc. v. Avagliano*, 457 U.S. 176, 180, 102 S.Ct. 2374, 2377, 72 L.Ed.2d 765 (1982) (quoting *Maximov v. United States*, 373 U.S. 49, 54, 83 S.Ct. 1054, 1057, 10 L.Ed.2d 184 (1963)). While possessing the force and effect of law, international agreements should be construed more like contracts than statutes. *See Santovincenzo v. Egan*, 284 U.S. 30, 40, 52 S.Ct. 81, 84, 76 L.Ed. 151 (1931) (international agreements are contracts between foreign states).

TAX EXEMPTION ISSUE

The issue before the court is one of first impression in this circuit. Lower courts generally have held for the government

[3]At oral argument, counsel for the government conceded that this case may be decided on the record.

on this issue.[4] Recently, the Federal Circuit reversed the 46-page opinion for the taxpayers by Claims Court Chief Judge Kozinski. *Coplin v. United States*, 761 F.2d 688 (Fed.Cir.1985), *rev'g*, 6 Cl.Ct. 115 (1984). Appellees in the present case are supported by a group of similarly situated taxpayers as amici curiae, some of whom were appellees in the Coplin case.[5]

Our disagreement with the Federal Circuit concerns the admissibility of the diplomatic note submitted to both courts just before oral argument. The Federal Circuit accepted the note. *See Coplin*, 761 F.2d at 691 (denying appellees' motions to strike diplomatic note and cable from U.S. Embassy in Panama). Appellees' petitions for rehearing which attacked the note's reliability were denied.[6]

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[4]*Rego v. United States*, 591 F.Supp. 123 (W.D.Tenn.1984); *Stabler v. United States*, 84-1 U.S.Tax Cas. (CCH) ¶ 9153 (N.D.Tex.1983); *Hollowell v. United States*, 84-1 U.S.Tax Cas. (CCH) ¶ 9142 (M.D.Fla.1983); *Pierpoint v. United States*, 83-2 U.S.Tax Cas. (CCH) ¶ 9647 (D.S.C.1983); *Snider v. United States*, 53 A.F.T.R.2d 349 (W.D.Wash.1983); *Stokes v. United States*, 83-2 U.S.Tax Cas. (CCH) ¶ 9644 (W.D.Wash.1983); *Long v. United States*, No. 83-158 (D.Or. July 22, 1983); *Swearingen v. United States*, 565 F.Supp. 1019 (D.Colo.1983); *Watson v. United States*, 592 F.Supp. 701 (W.D.Wash.1983); *Corliss v. United States*, 567 F.Supp. 162 (W.D.Ark.1983); *Highley v. United States*, 574 F.Supp. 715 (M.D.Tenn.1983); *Vamprine v. Commissioner*, T.C.M. (CCH) 1984-624; *Smith v. Commissioner*, 83 T.C. 702 (1984); *Collins v. Commissioner*, T.C.M. (CCH) 1983-762; *McCain v. Commissioner*, 81 T.C. 918 (1983).

Contra Harris v. United States, 585 F.Supp. 862 (S.D.Ga.1984); *Coplin v. United States*, 6 Cl.Ct. 115 (1984), *rev'd*, 761 F.2d 688 (Fed.Cir.1985).

[5]Taxpayers were represented at oral argument by counsel for the taxpayers in the *Coplin* case. Amici were represented in this appeal by the former General Counsel for the Panama Canal Commission.

[6]Taxpayers noted the suspicious introduction of this evidence due to a recent $40 million gift to the Panamanian government whose administration had changed in October 1984. Taxpayers further attacked the "strangely identical" letters attached to the note from persons who were not active negotiators of the provision in question. Lastly, the appellees in *Coplin* suggested that the note could not be considered as evidence of intent in September 1977. At best, it showed intent as of February 1985.

In *Coplin*, the Claims Court construed paragraph two literally because the United States government presented no statement of the official Panamanian position. See 84-2 U.S.Tax Cas. (CCH) at 85,002. Chief Judge Kozinski suggested that the absence of a diplomatic note hurt the government's position. *Id.* at 85,003 (drawing a negative inference from the government's refusal to produce evidence of Panamanian intent).

For the Federal Circuit, the diplomatic note and letters delivered to the panel the day of oral argument were dispositive. See Additional Views of Judges Bissell and Smith, 761 F.2d at 692. However, the records in *Coplin* and *Harris* are different. We reject the matters that were not presented to the lower court. On our record, the taxpayers must prevail.

a. The Language

The district court placed determinative reliance on the "unmistakably clear" language of paragraph two of Article XV. Judge Bowen wrote, "I read this paragraph as being subject to or needful of no interpretation. It says what it says." 585 F.Supp. at 863. Rejecting the government's legislative history, the court wrote: "It would take a higher intellect than mine to construe confusion where there is so much clarity in the language utilized." *Id.*, unnumbered footnote.

Paragraph two of Article XV speaks in clear and sweeping terms. It provides that U.S. citizen employees of the PCC "*shall be exempt from any taxes*, fees, or other charges on income received as a result of their work for the Commission" (emphasis added). The government concedes that a broad exemption from domestic taxation exists if the language is given its literal effect. It asserts, however, that such an interpretation is achieved only by wrenching the words out of context. We disagree.

In contrast to the all-inclusive language found in paragraph two, paragraph one establishes an exemption for the Commission itself, limited "to payment in the Republic of Panama of all

taxes". Paragraph three, dealing with personal property, gift and inheritance taxes of U.S. citizen employees, contains an identical limitation. It provides that the presence of the property of Americans "within the territory of the Republic of Panama shall not give rise to the exercise of taxing jurisdiction."

The absence of limiting language in paragraph two, in contrast to paragraphs one and three, demonstrates that "exempt from any taxes" meant just that. Paragraph two was not intended to create an exemption only from payment of Panamanian taxes. The presence of the specific limiting language in paragraphs one and three is persuasive evidence that the absence of similar language in paragraph two was intentional.

The government contends, however, that the presence of the limiting language in paragraphs one and three shows that such language also was intended to be used in paragraph two, except that it was omitted by inadvertence or oversight. This assumes that the government was represented by an inexperienced negotiating team whose drafting errors now need rectification. That was not the case. It was represented by a distinguished negotiating team, obviously aware that the Treaty was a foreign policy mission of the highest magnitude.

Reviewing other taxation provisions of the Treaty package, we find specific references to Panamanian taxation. For example, paragraph 9 of Article IX provides that vessels passing through the Canal "shall be exempt from any taxes . . . by the Republic of Panama." Similarly, paragraph 2(e) of Article XI of the Agreement provides that U.S. PCC contractors "shall not be obliged to pay any tax . . . to the Republic of Panama" provided they are taxed in the U.S. at a substantially equivalent rate. As noted by Judge Kozinski in *Coplin*, "This is an agreement drafted by sophisticated parties, obviously capable of using precise language." 6 Cl.Ct. at 127.

The affidavit of Michael Kozak, State Department negotiator, indicates that the operative language of Article XV was taken from the standard Status of Forces Agreement (SOFA) negotiated between the U.S. and foreign countries in which

U.S. armed forces members and employees are stationed. The SOFA language is virtually identical to the language of paragraph two of Article XV in the Agreement before us except that in the second sentence an explicit reference is made to taxation "as is provided by Panamanian law":

> Members of the Forces or the civilian component, and dependents, shall be exempt from any taxes, fees, or other charges on income received as a result of their work for the United States Forces or for any of the service facilities referred to in Article XI or XVIII of this Agreement. Similarly, *as is provided by Panamanian law*, they shall be exempt from payment of taxes, fees, or other charges on income derived from sources outside of the Republic of Panama.

Article XVI, Agreement in Implementation of Article IV of the Panama Canal Treaty, Sept. 7, 1977, T.I.A.S. No. 10032 (emphasis added). Amici report that an earlier draft, dated June 26, 1977, of the tax exemption language at issue contained the reference to Panamanian law underscored above.[7] Again, deletion of qualifying language must be considered deliberate.

Moreover, tax exemption clauses are well known to the Treasury, Defense, and State Departments from other treaties. Given this depth of experience, we cannot accept the government's position that its negotiating team adopted language that incorrectly expressed the intent of the Treaty signatories.

b. Legislative History and Treaty Negotiations

As previously noted, clear treaty language controls unless it effects a result inconsistent with the intent and expectations of the signatories. *Sumitomo*, 457 U.S. at 180, 102 S.Ct. at 2377. Where language is susceptible to differing interpretations, extraneous materials bearing on the parties' intent should be considered. *Hidalgo County Water Control and Improvement*

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[7]At oral argument, counsel for the government suggested that the phrase "as is provided by Panamanian law," was dropped from the second sentence of paragraph two because it was merely "surplusage."

District v. Hedrick, 226 F.2d 1, 8 (5th Cir.1955), *cert. denied*, 350 U.S. 983, 76 S.Ct. 469, 100 L.Ed. 851 (1956); *Corliss v. United States*, 567 F.Supp. 162, 164 (W.D.Ark.1983). Here, we must consider the interests and intentions of both parties to the Treaty "to secure equality and reciprocity between them." *Jordan v. Tashiro*, 278 U.S. 123, 127, 49 S.Ct. 47, 48, 73 L.Ed. 214 (1928).

The district court had before it the affidavit of Dr. Carlos Alfredo Lopez Guevara, Ambassador Extraordinary and Plenipotentiary, who acted as the chief Panamanian negotiator. Guevara stated that the United States proposed the language of paragraph two without explanation, and the Panamanians accepted it without objection. Guevara said further that the language of paragraph two was intended to preclude both the United States and Panama from taxing American employees of the PCC, that it was so read by Panama, and that a contrary interpretation by the United States would be viewed as a material breach of the treaty. At oral argument, counsel for the government characterized Guevara's affidavit as personal statements "out of step" with his government.

Plaintiffs' summary judgment motion was supported also by sworn statements from Juan Antonio Tack, Minister of Foreign Relations and head of the Panamanian negotiating staff between 1970 and 1976; and Demetrio B. Lakas, Panama's then President. Both said clearly that the language at issue created a tax exemption for U.S. citizen PCC employees in both countries. Tack's letter, interpreted from Spanish, stated: "The general spirit of such a provision was that the U.S. citizens working in the canal administration should be granted some type of economic incentive, in addition to their salaries, for obtaining the highest yield in their specialized functions."

In fact, many provisions of the Treaty secured PCC employees' rights and created special inducements for them to remain on the job.[8] Taxpayers' suggestion that a U.S. tax

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[8]For example, Article X, paragraph 10(b) creates an affirmative duty on

exemption was intended as part of the package of inducements is not unreasonable.

The only affidavit filed by the government in support of its summary judgment motion was that of Michael Kozak, Deputy Legal Advisor to the State Department. The Kozak affidavit undermines the government's position. Unlike Guevara, Kozak was not privy to the actual negotiations on the tax exemption issue.

Counsel for the government conceded in *Coplin* that the Kozak affidavit "may not be used to divine the purpose of Article XV." 6 Cl.Ct. at 132 n. 16. Several lower courts holding for the government relied on the unimpeached Kozak affidavit. *See, e.g., Stabler v. United States*, 84-1 U.S.Tax Cas. (CCH) ¶ 9153, at 81,185-86 (N.D.Tex.1983); *Pierpoint v. United States*, 83-2 U.S.Tax Cas. (CCH) ¶ 9647, at 88,329 (D.S.C.1983).

The government's reliance on the Senate hearings and Senate Report accompanying the Treaty also is misplaced. In its brief, the government quotes this interchange between Senator Richard Stone and Herbert J. Hansell, Legal Advisor to the State Department, who was testifying before the Senate Foreign Relations Committee:

> Senator STONE: I think it was article XV, section 1 that raised an interesting question. I will read it to you. 'By virtue of this agreement the Commission, its contractors and subcontractors are exempt from payment in the Republic of Panama of all taxes, fees, or other charges on their activities or properties.' Then, in No. 2, referring to U.S. citizen employees and dependents, it says, 'shall be

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the part of the U.S. to seek legislation which provides more liberal retirement benefits. Other provisions of the Agreement that favor PCC employees include: Article XII, Entry and Departure; Article XIII, Services and Installations; Article XIV, Licenses; Article XVI, Import Duties; Article XVIII, Claims; and Article XIX, Criminal Jurisdiction.

exempt from any taxes, fees, or other charges on income received as a result of their work for the Commission. Similarly, they shall be exempt from payments of taxes, fees, or other charges on income derived from sources outside the Republic of Panama.'

Of course, when that was announced, the press reported the glee of the Zonians that they were now exempt from U.S. income tax. When Senator Glenn asked you, are there any words that you would like to see in the treaty, I was just asking myself, would you like to see the words, United States, in there somewhere?

Mr. HANSELL. I am sorry to be a source of disappointment for the Panamanians, but obviously we are not entering into an agreement between the United States and Panama that would exempt U.S. citizens from U.S. tax. The purpose of this, of course, was to exempt them from Panamanian tax.

* * *

Senator STONE. Wouldn't you think that we could put in the understanding that I suggested to you, the clarification of our interpretation which then, when ratified by the Congress, by the Senate, and deposited, would clarify that in a little more formal way than simple advices, since you don't want to put words back in the treaty through negotiation? Mr. HANSELL. The one comment I would have with respect to that, and this relates to a couple of other points, is that we are dealing now with an internal U.S. matter, not a matter between the United States and Panama. That is, we don't agree with Panama how we are going to tax our citizens. That is obviously an internal matter. I would hope we could find ways of dealing with internal matters other than as understandings.

Panama Canal Treaties: Hearings Before the Committee on Foreign Relations, 95th Cong., 1st Sess. 268 (1977).

Far from supporting the government, the colloquy underscores the significance of the government's failure to clarify

Article XV(2). The Senator was concerned that the tax issue could spawn litigation and suggested clarification through one of several established diplomatic channels. Hansell rejected the suggestion and responded by characterizing it as an "internal matter" which the government would find a way to avoid.

Moreover, Senator Stone's suggestion that the taxation issue be clarified through an exchange of notes or an "understanding" comports with standard diplomatic negotiating practice. The day the Treaty was signed, there was an extensive exchange of notes between the two nations. These notes supplied additional clarification and assurances regarding many of the provisions covered in the Treaty documents. *See, e.g., Exchange of Notes Relating to Post Services*, Sept. 7, 1977, reprinted in S.Exec.Rep. 95-12, 95 Cong., 1st Sess. (1978), at 726. We find no note exchange pertaining to Article XV on taxation despite ample opportunity between September 1977 when the Treaty documents were signed and October 1979 when they became effective.

Nor does Senate Executive Report No. 95-12 provide competent evidence on intent of the parties to the Agreement. The government urges that we give great weight to the meaning ascribed to Article XV(2) by the federal department charged with the Treaty's negotiation and enforcement. It relies on the State Department's section by section analysis included in the Senate Foreign Relations Committee Report for such meaning.

However, in *Coplin*, the government conceded that the section by section analyses were prepared by Michael Kozak and Geraldine Chester, neither of whom were present at any negotiating session during which the substance of Article XV was discussed. The government conceded also that the analyses were prepared after the negotiations had been completed and the Treaty documents had been signed. Coplin, 6 Cl.Ct. at 128. We reject the government's attempt to establish intent through documents it prepared after the fact.[9] *Cf. Consumer Product*

[9]The dearth of evidence of negotiating history before *Coplin* was tried in the Claims Court may explain why lower courts generally have ruled for the government.

Safety Commission v. GTE Sylvania, Inc., 447 U.S. 102, 118, 100 S.Ct. 2051, 2061, 64 L.Ed.2d 766 (1980) (remarks of a single legislator on the committee are not controlling on legislative history).

Again, many of the lower courts that ruled for the government on this issue relied on the unimpeached Senate Report. *See, e.g., Rego v. United States*, 591 F.Supp. 123, 124 (W.D.Tenn.1984); *Corliss*, 567 F.Supp. at 165-66; *McCain v. Commissioner*, 81 T.C. 918, 928-29 (1983). In sum, the competent affidavits and legislative history before the district court fully support the taxpayers' position that the parties intended a bi-national tax exemption.

c. Other Considerations

The government contends erroneously that unrestricted U.S. taxation of income earned in Panama by Americans would mirror the pre-1977 *status quo*. As previously indicated, American citizen PCC employees historically were either free of U.S. tax (before 1951) or taxed at a reduced level (after 1951). We consider the tax treatment of PCC employees to be a unique situation. Appellees, therefore, are not subject to the fundamental principle of U.S. tax law that the world-wide income of U.S. citizens is subject to taxation by this government regardless of the person's residence or the source of that income. *See Cook v. Tait*, 265 U.S. 47, 56, 44 S.Ct. 444, 445, 68 L.Ed. 895 (1924).[10]

Amici report that in 1974, only 88 Americans residing in Pan-

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[10]"Gross income" in Section 61 of the Internal Revenue Code of 1954 does not include income excluded "by any treaty obligation of the United States." 26 U.S.C. § 894(a) (1982). As the Supreme Court recognized in *Weinberger v. Rossi*, 456 U.S. 25, 29, 102 S.Ct. 1510, 1514, 71 L.Ed.2d 715 (1982), "The word 'treaty' has more than one meaning." We are persuaded that the phrase "treaty obligation" in Section 894 is broad enough to include executive agreements that are signed by the President pursuant to constitutional or statutory authority.

ama filed income tax returns. The total income of these Americans averaged about $32,000 and, according to Treasury Department estimates, produced about $600,000 of tax liability. Compared to the significant economic concessions made by this government as part of the Treaty package, the amount of potential tax revenues that would be lost through the exemption at issue may be considered slight.

Moreover, the number of Americans to benefit by a tax exemption is declining. Article III, paragraph 8, of the Treaty provides for "growing participation" of Panamanian nationals at all levels and areas of employment, with the objective of preparing, in an orderly fashion, for the assumption of full responsibility for Panamanian management of the canal in the year 2000.

In conclusion, we find that the clear language of Article XV(2) of the Agreement creates a bi-national tax exemption for PCC employees. The government has failed to produce competent evidence that Panama and the United States "intended to agree on something different from that appearing on the face of" Article XV of the Agreement. *Choctaw Nation of Indians v. United States*, 318 U.S. 423, 432, 63 S.Ct. 672, 678, 87 L.Ed. 877 (1943) (Indian treaties). The government must live with the language it drafted.

AFFIRMED.

Supreme Court, U.S.
FILED
DEC 3 1985
JOSEPH F. SPANIOL, JR.
CLERK

Nos. 85-558, 85-559 and 85-560

In the Supreme Court of the United States

OCTOBER TERM, 1985

ROBERT E. O'CONNOR AND GLADYS E. O'CONNOR,
PETITIONERS

v.

UNITED STATES OF AMERICA

PAUL H. COPLIN AND PATRICIA COPLIN, PETITIONERS

v.

UNITED STATES OF AMERICA

JACK R. MATTOX AND MARIA MATTOX, PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITIONS FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

BRIEF FOR THE UNITED STATES

CHARLES FRIED
Solicitor General

GLENN L. ARCHER, JR.
Assistant Attorney General

MICHAEL L. PAUP
DAVID ENGLISH CARMACK
Attorneys

Department of Justice
Washington, D.C. 20530
(202) 633-2217

QUESTION PRESENTED

Whether the court below correctly determined that Article XV of the Agreement in Implementation of Article III of the Panama Canal Treaty, Sept. 7, 1977, United States-Panama, T.I.A.S. No. 10031, did not exempt the petitioners from United States taxation on the salaries that they received from the Panama Canal Commission.

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Agreement in Implementation of Article IV of the Panama Canal Treaty, Sept. 7, 1977, United States-Panama, T.I.A.S. No. 10032:
Art. XVI 9, 12
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In the Supreme Court of the United States

OCTOBER TERM, 1985

No. 85-558

ROBERT E. O'CONNOR AND GLADYS E. O'CONNOR, PETITIONERS

v.

UNITED STATES OF AMERICA

No. 85-559

PAUL H. COPLIN AND PATRICIA COPLIN, PETITIONERS

v.

UNITED STATES OF AMERICA

No. 85-560

JACK R. MATTOX AND MARIA MATTOX, PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITIONS FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

BRIEF FOR THE UNITED STATES

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-8a) is reported at 761 F.2d 688. The opinion of the United States Claims Court (Pet. App. 9a-69a) is reported at 6 Cl. Ct. 115.

JURISDICTION

The judgments of the court of appeals were entered on May 10, 1985, and petitions for rehearing were denied on July 3, 1985 (Pet. App. 70a-71a). The petitions for a writ of certiorari were filed on September 30, 1985. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

TREATY AND EXECUTIVE AGREEMENT INVOLVED

Article III, paragraph 9, of the Panama Canal Treaty, Sept. 7, 1977, United States-Panama, T.I.A.S. No. 10030, and Article XV of the Agreement in Implementation of Article III of the Panama Canal Treaty, T.I.A.S. No. 10031, are set forth in App. A, *infra*.

STATEMENT

1. On September 7, 1977, the United States and the Republic of Panama signed the Panama Canal Treaty, which was approved by the Senate and entered into force on October 1, 1979. That treaty restored to Panama territorial sovereignty over the Canal Zone, while granting to the United States the right to manage, operate and maintain the canal until the year 2000 under the auspices of the Panama Canal Commission (Commission), an agency of the United States government (Pet. App. 3a). Article III, paragraph 9, of the treaty provides in pertinent part that "the rights and legal status of United

States Government agencies and employees operating in the Republic of Panama pursuant to this Article, shall be governed by the Agreement in Implementation of this Article, signed this date." Article XV of the Agreement in Implementation of Article III of the Panama Canal Treaty, also signed on September 7, 1977, provides in pertinent part as follows:

Taxation

> 1. By virtue of this Agreement, the Commission, its contractors and subcontractors, are exempt from payment in the Republic of Panama of all taxes, fees or other charges on their activities or property.
>
> 2. United States citizen employees and dependents shall be exempt from any taxes, fees, or other charges on income received as a result of their work for the Commission. Similarly, they shall be exempt from payment of taxes, fees or other charges on income derived from sources outside the Republic of Panama.
>
> 3. United States citizen employees and dependents shall be exempt from taxes, fees, or other charges on gifts or inheritance or on personal property, the presence of which within the territory of the Republic of Panama is due solely to the stay therein of such persons on account of their or their sponsor's work with the Commission.

2. Petitioners Robert O'Connor, Paul Coplin and Jack Mattox are United States citizens who were employed by the Commission during the relevant tax years.[1] The wages they received from the Commission

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[1] Gladys E. O'Connor, Patricia Coplin and Maria R. Mattox are parties to these suits because each filed a joint tax return with her husband. Unless otherwise stated, we will refer to Robert O'Connor, Paul Coplin and Jack Mattox as petitioners.

were included in computing their federal income tax for years 1979 (Coplin), 1980 (Mattox) and 1981 (O'Connor and Mattox). Thereafter, petitioners filed claims for refund for the amount of tax paid with respect to income received from the Commission, urging that Article XV of the Agreement in Implementation of Article III of the Panama Canal Treaty exempted that income from domestic taxation. The Internal Revenue Service denied each of their claims, and each petitioner filed a suit for refund in the Claims Court (Pet. App. 2a).

The Claims Court rejected the government's argument that Article XV of the Implementation Agreement was not intended to restrict the right of the United States to tax its citizens. The Claims Court also determined that, even though the Executive Branch had consistently interpreted the Agreement as implicating only Panamanian taxes, a broad, literal interpretation of the Implementation Agreement was required because the government presented "*no evidence whatsoever* as to the interpretation given this language by Panama" (Pet. App. 3a, 29a, 61a-66a, 68a-69a (emphasis in original)).

3. On appeal, the Federal Circuit unanimously reversed. Shortly before oral argument in the court of appeals, the Foreign Minister of the Republic of Panama delivered to the United States government a diplomatic note confirming that the Foreign Ministry of Panama agreed with the United States that Article XV of the Implementation Agreement was not intended to affect United States taxation of Commission employees (App. B, *infra*, 4a-9a; Pet. App. 5a). The Federal Circuit denied petitioners' motion to strike the Panamanian government's note and, con-

sistent with decisions of this Court, considered the views of the Panamanian government. The court stated (Pet. App. 6a) that its role in treaty matters was limited "'to giving effect to the intent of the Treaty parties.'" Since the treaty partners agreed that Article XV of the Implementation Agreement did not exempt the salaries paid to the Commission's United States citizen employees from domestic taxation, the trial court's contrary determination was reversed (Pet. App. 6a-7a). In a concurring opinion, three members of the five judge panel concluded (Pet. App. 8a) that "[a] complete reading of the record [before the Claims Court], the treaty and the Implementation Agreement" indicated that Article XV had no bearing on the power of the United States to tax its own citizens and that it was not necessary to consider the note from the Panamanian government to reach that result.

DISCUSSION

The decision below correctly held that Article XV of the Implementation Agreement did not exempt United States citizens from United States taxation on salaries paid by the Commission.

1. The world-wide income of United States citizens is subject to taxation by the United States regardless of the citizen's residence or the source of such income. Section 1, Internal Revenue Code of 1954 (26 U.S.C.); *Cook* v. *Tait*, 265 U.S. 47, 56 (1924). As has long been recognized, exemption from taxation is a matter of legislative grace and must be granted explicitly. *HCSC-Laundry* v. *United States*, 450 U.S. 1, 5 (1981); *Commissioner* v. *Glenshaw Glass Co.*, 348 U.S. 426, 429-430 (1955); *Helvering* v. *Northwest Steel Rolling Mills, Inc.*, 311 U.S. 46,

49 (1940); *United States Trust Co.* v. *Helvering*, 307 U.S. 57, 60 (1939). There is no merit to petitioners' claim that Article XV constitutes such an express exemption, permitting them to avoid all taxation on the salaries received from the Commission.

As this Court has indicated, the role of a court in interpreting international agreements is "limited to giving effect to the intent of the Treaty parties." *Sumitomo Shoji America, Inc.* v. *Avagliano*, 457 U.S. 176, 185 (1982). See also *In re Ross*, 140 U.S. 453, 475 (1891). In determining that intent, the courts appropriately examine not only the language used in the treaty, but also the context in which the language is used, the history of negotiations underlying the agreement and the proceedings before the Senate. See *Sumitomo Shoji America, Inc.* v. *Avagliano*, 457 U.S. at 180; *Factor* v. *Laubenheimer*, 290 U.S. 276, 294-295 (1933); *Nielsen* v. *Johnson*, 279 U.S. 47, 52 (1929). Indeed, this Court has not confined its search for guides to the intent of the parties to documents presented to lower courts, but has examined records and expressions of intent of a foreign government that were presented to it for the first time. *Sumitomo Shoji America, Inc.* v. *Avagliano*, 457 U.S. at 184, n.9; *Factor* v. *Laubenheimer*, 290 U.S. at 295 (this Court's order for reargument invited counsel to conduct a further search through available diplomatic records and correspondence); *United States* v. *Reynes*, 50 U.S. (9 How.) 127, 147-148 (1850).

While the ultimate goal of adjudication is to effect the treaty partners' intent, it has long been settled that the construction of an international agreement by the Executive Branch is entitled to great deference by the courts. *Sumitomo Shoji America, Inc.* v. *Avagliano*, 457 U.S. at 180-184; *Factor* v. *Lauben-*

heimer, 290 U.S. at 295. It is, after all, the Executive Branch that is charged with conducting foreign affairs. For that reason, deference is the rule even when the treaty partner takes a view different from that taken by the United States. *Factor* v. *Laubenheimer*, 290 U.S. at 298; *Charlton* v. *Kelly*, 229 U.S. 447, 473 (1913); *Whitney* v. *Robertson*, 124 U.S. 190, 194-195 (1888); *United States* v. *A.L. Burbank & Co.*, 525 F.2d 9, 15 (2d Cir. 1975), cert. denied, 426 U.S. 934 (1976). When, however, "the parties to a treaty both agree as to the meaning of a treaty provision, and that interpretation follows from the clear treaty language, we must, absent extraordinarily strong contrary evidence, defer to that interpretation." *Sumitomo Shoji America, Inc.* v. *Avagliano*, *supra*, 457 U.S. at 185. In the present case, the United States has consistently maintained that Article XV of the Implementation Agreement does not exempt from United States taxation the salaries paid to the Commission's United States citizens.

2. An examination of the language of Article XV, the history surrounding its negotiations, and the proceedings leading to Senate ratification of the Treaty underlying the Agreement indicates that it was not intended in any way to restrict the right of the United States to tax its citizens working for the Commission. Paragraph 1 of Article XV exempts the Commission, its contractors and subcontractors from Panamanian taxes. Paragraph 3 of Article XV exempts United States citizen employees of the Commission and their dependents from payment of taxes, fees or other charges on gifts, inheritance and personal property found within the Republic of Panama on account of their own or their sponsor's work for the Panama Canal Commission. Paragraph 2 of that article, which is at issue in this case, provides that

"United States citizen employees and dependents shall be exempt from any taxes, fees, or other charges on income received as a result of their work for the Commission." If there is any doubt that, in context, this refers only to Panamanian tax, that doubt is resolved by the Article's following sentence, which exempts United States citizen employees of the Commission "from payment of taxes, fees or other charges on income derived from sources outside Panama." To read paragraph 2 as petitioners propose would give credence to the argument that even interest earned on United States bank accounts and dividends from domestic corporations are exempt from United States income tax.

Such a result is clearly absurd. Accordingly, even without considering the recent Panamanian diplomatic note, a large majority of courts [2] (and the ma-

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[2] The Tax Court and many district courts have interpreted Article XV, paragraph 2, of the implementing agreement to exempt salaries of United States citizen employees of the Commission from Panamanian income tax, not from United States income tax. *Smith* v. *Commissioner*, 83 T.C. 702 (1984); *McCain* v. *Commissioner*, 81 T.C. 918 (1983); *Bergman* v. *Commissioner*, 50 T.C.M. (CCH) 158 (1985); *Vamprine* v. *Commissioner*, 49 T.C.M. (CCH) 210 (1984), appeal pending, No. 85-4150 (5th Cir.); *Collins* v. *Commissioner*, 47 T.C.M. (CCH) 713 (1983); *Rego* v. *United States*, 591 F. Supp. 123 (W.D. Tenn. 1984); *Stabler* v. *United States*, 84-1 U.S.T.C. para. 9153 (N.D. Tex. Nov. 30, 1983); *Hollowell* v. *United States*, 84-1 U.S.T.C. ¶ 9142 (M.D. Fla. Nov. 21, 1983); *Corliss* v. *United States*, 567 F. Supp. 162 (W.D. Ark. 1983); *Pierpoint* v. *United States*, 83-2 U.S.T.C. ¶ 9647 (S.C. Oct. 3, 1983); *Snider* v. *United States*, 53 A.F.T.R. 2d 349 (W.D. Wash. Sept. 23, 1983); *Stokes* v. *United States*, 83-2 U.S.T.C. ¶ 9644 (W.D. Wash. Aug. 29, 1983). Accord: unreported Western District of Arkansas opinion in *Skrable* v. *United States*, appeal pending No. 85-1743WA (8th Cir.). See also *Billman* v. *Commissioner*, 83 T.C. 534, 541 n.6 (1984). To the

jority of judges on the Federal Circuit panel) has concluded that Article XV focuses exclusively on Panamanian taxation. As those courts have held, the Article's purpose is to extend protections to United States citizen employees of the Commission from taxation by Panama, not to relieve them of their duty to pay United States taxes. This construction is supported by the negotiating history underlying the Treaty and Agreement, which indicates that Panamanian taxes alone were the subject of discussions between the parties. The Legal Adviser of the State Department testified before the Senate Foreign Relations Committee during its considerations of the Panama Canal Treaty that paragraph 2 of Article XV related only to Panamanian taxation, not to United States taxation. *Panama Canal Treaties Before the Senate Comm. on Foreign Relations*, 95th Cong., 1st Sess., Pt. 1, at 268-269 (1977); App. C, *infra*, 10a-12a. The section-by-section analysis of the Treaty and its implementing agreements prepared by the State Department for the United States Senate likewise stated that the Implementing Agreement provided an exemption only from Panamanian taxation. S. Exec. Rep. 95-12, 95th Cong., 2d Sess. 155

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contrary, see *Harris* v. *United States*, 585 F. Supp. 862, 863 (N.D. Ga. 1984), aff'd, 768 F.2d 1240 (11th Cir. 1985). In *Swearingen* v. *United States*, 565 F. Supp. 1019 (Colo. 1983), the court held that an executive agreement, which the Implementation Agreement is, exempting United States citizens from taxation was not within the constitutional powers of the President. In addition, the Tax Court has recently held that in the virtually identical provision of Article XVI of the Agreement in Implementation of Article IV of the Panama Canal Treaty, T.I.A.S. 10032, App. A, *infra* 2a-3a, United States citizen employees of the United States Armed Forces stationed in Panama were not exempt from United States taxation. *Rust* v. *Commissioner*, 85 T.C. No. 15 (Aug. 15, 1985).

(1978). In the introduction to the section-by-section analysis, the Senate Report (*id.* at 127) stated that the analysis was—

> prepared by members of the treaty negotiating team and have been approved by the offices of the State and Defense Departments directly involved in the negotiations * * *. Accordingly, these comments may be considered as an authoritative source of information with respect to the negotiating background and interpretation of the Treaties.

The documentary evidence also reveals that the person who drafted Article XV was likewise one of the drafters of the section-by-section analysis (I C.A. App. 25-26, 46, 64).

3. The foregoing analysis makes clear that, even in the absence of the recent Panamanian diplomatic note, the judgment of the court of appeals is correct. Upon submission of the Panamanian note the point was made conclusively. Even if, as petitioners contend, the language of Article XV suggests a different result, this Court has established that such language does not control if it " 'effects a result inconsistent with the intent or expectations of its signatories.' " *Sumitomo Shoji America, Inc.* v. *Avagliano*, 457 U.S. at 180, quoting *Maximov* v. *United States*, 373 U.S. 49, 54 (1963). Thus, it was entirely correct for the court below to consider the diplomatic note presented to the United States by the Government of the Republic of Panama. Under well-established rules, when both government parties to a bilateral agreement have concurred in its interpretation, it is inappropriate for courts to chart a different course. In discharging its function of treaty interpretation, this Court has consistently turned to authoritative governmental statements, even those made available only late in the

proceedings. *United States* v. *Pink*, 315 U.S. 203, 220-221 (1942). And, once a foreign government presents a statement dealing with matters within its area of sovereign authority, American courts are obligated to accept that statement at face value as "conclusive." *Ibid.*

4. We acknowledge, however, that the decisions of the Federal Circuit conflict with the recent decision of the Eleventh Circuit in *Harris* v. *United States*, 768 F.2d 1240 (1985). In our view, *Harris* fails properly to apply the canons of treaty interpretation set forth by this Court and, in the end, grants an exemption from domestic taxation intended by neither of the treaty partners. Indeed, the Eleventh Circuit's error in disregarding these rules of construction was compounded by its error in refusing to consider the Panamanian diplomatic note because it had not been presented to the lower court. That ruling is directly in conflict not only with the Federal Circuit's contrary ruling in the present cases, but also with the authorities of this Court. *Sumitomo Shoji America, Inc.* v. *Avagliano*, *supra*.

5. As matters now stand, United States citizens who were and are employees of the Commission are subject to different rules of taxation on their salaries from the Commission depending upon where they reside and upon the court in which their claim is heard. The issues presented here are now pending in cases in the Fifth, Eighth, and Eleventh Circuits. We have been informed by the Chief Counsel of the Internal Revenue Service that a recent survey indicates that 1714 cases involving $32,607,000 in tax are either pending administratively or in litigation. The Chief Counsel further informs us that 2000 United States citizens were employed by the Commis-

sion in 1979, 1655 in 1984 and 1360 in 1985. In addition, there are 3890 cases with $13,283,000 in tax involving the exemption of military personnel from taxation under a virtually identical provision in Article XVI(2) of the Agreement in Implementation of Article IV of the Panama Canal Treaty, App. A., *infra*. Given the undisputed conflict of decisions and the administrative importance of the question, we do not oppose the petitions for a writ of certiorari.

CONCLUSION

The petitions for a writ of certiorari should be granted.

Respectfully submitted.

CHARLES FRIED
Solicitor General

GLENN L. ARCHER, JR.
Assistant Attorney General

MICHAEL L. PAUP
DAVID ENGLISH CARMACK
Attorneys

DECEMBER 1985

APPENDIX A

Panama Canal Treaty Between the United States of America and Panama, Sept. 7, 1977, T.I.A.S. No. 10030:

ARTICLE III

Canal Operation and Management

* * * * *

9. The use of the areas, waters and installations with respect to which the United States of America is granted rights pursuant to this Article, and the rights and legal status of United States Government agencies and employees operating in the Republic of Panama pursuant to this Article, shall be governed by the Agreement in Implementation of this Article, signed this date.

* * * * *

Agreement Between the United States of America and Panama in Implementation of Article III of the Panama Canal Treaty, Sept. 7, 1977, T.I.A.S. No. 10031:

ARTICLE XV

Taxation

1. By virtue of this Agreement, the Commission, its contractors and subcontractors are exempt from payment in the Republic of Panama of all taxes, fees or other charges on their activities or property.

2. United States citizen employees and dependents shall be exempt from any taxes, fees, or

other charges on income received as a result of their work for the Commission. Similarly, they shall be exempt from payment of taxes, fees or other charges on income derived from sources outside the Republic of Panama.

3. United States citizen employees and dependents shall be exempt from taxes, fees, or other charges on gifts or inheritance or on personal property, the presence of which within the territory of the Republic of Panama is due solely to the stay therein of such persons on account of their or their sponsor's work with the Commission.

4. The Coordinating Committee may establish such regulations as may be appropriate for the Implementation of this Article.

Agreement Between the United States of America and Panama in Implementation of Article IV of the Panama Canal Treaty, Sept. 7, 1977, T.I.A.S. No. 10032:

ARTICLE XVI

Taxation

(1) By virtue of this Agreement, the United States Forces are exempt from payment in the Republic of Panama of all taxes, fees or other charges on their activities or property, including those imposed through contractors or subcontractors.

(2) Members of the Forces or the civilian component, and dependents, shall be exempt from any taxes, fees, or other charges on income received as a result of their work for the United

States Forces or for any of the service facilities referred to in Articles XI or XVIII of this Agreement. Similarly, as is provided by Panamanian law, they shall be exempt from payment of taxes, fees or other charges on income derived from sources outside the Republic of Panama.

(3) Members of the Forces or the civilian component, and dependents, shall be exempt from taxes, fees or other charges on gifts or inheritance or on personal property, the presence of which within the territory of the Republic of Panama is due solely to the stay therein of such persons on account of their or their sponsor's work with the United States Forces.

(4) The Joint Committee may establish such regulations as may be appropriate for the implementation of this Article.

APPENDIX B

[Note from Government of the Republic of Panama, February 22, 1985]

DEPARTMENT OF STATE
Division of Language Services
(Translation)

LS NO. 115474-A
Emb/JRP
Spanish

[Text of Government of Panama note D.M. No. 34 from Foreign Minister Cardoze to Ambassador Briggs]

Mr. Ambassador:

I have the honor to refer to Article 15(2) of the Agreement in Implementation of Article III and to Article 16(2) of the Agreement in Implementation of Article IV of the Panama Canal Treaty of 1977.

I have consulted with Drs. Romulo Escobar Bethancourt, Aristides Royo, Adolfo Ahumada, and Jaime Arias Calderon, Panamanian negotiators of those agreements, and they have confirmed to me that the provisions referred to above were discussed, negotiated, and drafted exclusively with respect to the tax exemptions that the Republic of Panama would grant to United States-citizen employees of the Panama Canal Commission and their dependents and to members of the United States Armed Forces and the civilian component and their dependents. The aforementioned provisions resulted from negotiations which did not deal with the United States authority to tax the individuals mentioned therein.

The foregoing expresses the scope of the aforementioned provisions and also represents the interpretation of this Ministry.

Accept, Mr. Ambassador, the assurances of my highest consideration and personal esteem.

[s] Fernando Cardoze Fabrega
Minister of Foreign Relations

LS NO. 115474-B

[Text of Foreign Minister Cardoze's identical notes to Panamanian negotiators Adolfo Ahumada, Romulo Escobar Bethancourt, and James A. Arias]

In your capacity as negotiator of the Panama Canal Treaty, I should like to have your opinion on the correct interpretation of Article 15(2) of the Agreement in Implementation of Article III and Article 16(2) of the Agreement in Implementation of Article IV. Especially, there is an interest in determining whether the tax exemptions referred to in the aforementioned provisions, which are granted to United States-citizen employees of the Commission and their dependents and to employees of the United States Armed Forces and the civilian component and their dependents, refer to tax exemptions from both the Republic of Panama and the United States of America.

I avail myself of this opportunity to renew to you the assurances of my distinguished consideration and esteem.

LS No. 115474-C

[Text of Dr. Ahumada's February 21 reply]

Regarding your consultation of February 20, I am happy to confirm that Article 15(2) of the Agreement in Implementation of Article III and Article 16(2) of the Agreement in Implementation of Article IV of the Panama Canal Treaty of 1977 were discussed, negotiated, and drafted exclusively with respect to the tax exemptions that the Republic of Panama would grant to United States-citizen employees of the Commission and their dependents and to members of the United States Armed Forces and the civilian component and their dependents. The aforementioned provisions resulted from negotiations that did not deal with the United States authority to tax the individuals mentioned therein.

Accept, Mr. Minister, my high consideration.

LS No. 115474-D

[Text of Dr. Escobar's February 22 reply]

Regarding your consultation of February 20, I am happy to confirm that Article 15(2) of the Agreement in Implementation of Article III and Article 16(2) of the Agreement in Implementation of Article IV of the Panama Canal Treaty of 1977 were discussed, negotiated, and drafted exclusively with respect to the tax exemptions that the Republic of Panama would grant to United States-citizen employees of the Commission and their dependents and to members of the United States Armed Forces and the civilian component and their dependents. The aforementioned provisions resulted from negotiations that did not deal with the authority of the United States of America to tax the individuals mentioned therein.

Accept, Mr. Minister, my high consideration.

LS No. 115474-E

[Text of Jaime Arias' February 22 reply]

Regarding your consultation of February 21 and based on my participation in the negotiation and drafting of the Agreement in Implementation of Article IV of the Panama Canal Treaty of 1977, I am happy to confirm to you that Article 16(2) of the Agreement, in whose drafting I took part, and, in my opinion, Article 15(2) of the Agreement in Implementation of Article III of the Treaty, were discussed, negotiated, and drafted exclusively with respect to the tax exemptions that the Republic of Panama would grant to United States-citizen employees of the Commission and their dependents and to members of the United States Armed Forces and the civilian component and their dependents. The aforementioned provisions resulted from negotiations which did not deal with the United States authority to tax the individuals mentioned therein.

Accept, Mr. Minister, my high consideration.

CERTIFICATION OF TRANSLATION

I hereby certify that the above translation bearing LS No. 115474A-E was prepared by the Division of Language Services of the Department of State and that it is a correct translation to the best of my knowledge and belief.

Dated: February 27, 1985

Jorge R. Perez
JORGE R. PEREZ
Assistant Chief, Translating Branch

APPENDIX C

Panama Canal Treaties: Hearings before the Senate Comm. on Foreign Relations, 95th Cong., 1st Sess. Pt. 1, at 268-269 (1977)

EXEMPTION FROM PANAMANIAN TAXES

Senator STONE. Mr. Chairman, I will be brief. We are at the end of the allotted time. This question is addressed to Mr. Hansell. In your statement you refer to exemption from Panamanian taxes. Would you read from the appropriate agreement the appropriate phrase that you refer to in your statement?

Mr. HANSELL. There are several provisions. I am not sure whether they are in the treaties or in the Implementing Agreements. Let me see if I can find these. This is from the Implementing Agreements. Do you have a set of the Implementing Agreements, Senator?

Senator STONE. I just have the treaties. I don't have the agreements.

Mr. HANSELL. Article XV of the agreement in implementation of article III of the Panama Canal Treaty, and we can give you a set of these—

Senator STONE. I think it was article XV, section 1 that raised an interesting question. I will read it to you. "By virtue of this agreement the Commission, its contractors and subcontractors are exempt from payment in the Republic of Panama of all taxes, fees, or other charges on their activities or properties." Then, in No. 2, referring to U.S. citizen employees and dependents, it says, "shall be exempt from any taxes,

fees, or other charges on income received as a result of their work for the Commission. Similarly, they shall be exempt from payments of taxes, fees, or other charges on income derived from sources outside the Republic of Panama."

Of course, when that was announced, the press reported the glee of the Zonians that they were now exempt from U.S. income tax. When Senator Glenn asked you, are there any words that you would like to see in the treaty, I was just asking myself would you like to see the words, United States, in there somewhere?

Mr. HANSELL. I am sorry to be a source of disappointment for the Panamanians, but obviously we are not entering into an agreement between the United States and Panama that would exempt U.S. citizens from U.S. tax. The purpose of this, of course, was to exempt them from Panamanian tax.

Senator STONE. How would you clarify that in words of writing?

Mr. HANSELL. I believe that is actually under way by the authorities in Panama. The Army, I think, is preparing some information for the zone residents on all aspects of this, including the tax aspect.

Senator STONE. Wouldn't you think that we could put in the understanding that I suggested to you, the clarification of our interpretation which then, when ratified by the Congress, by the Senate, and deposited, would clarify that in a little more formal way than simple advices, since you don't want to put words back in the treaty through negotiation?

Mr. HANSELL. The one comment I would have with respect to that, and this relates to a couple

of other points, is that we are dealing now with an internal U.S. matter, not a matter between the United States and Panama. That is, we don't agree with Panama how we are going to tax our citizens. That is obviously an internal matter. I would hope we could find ways of dealing with internal matters other than as understandings.

Senator STONE. You understand that if the Zonians want to try to exert their exemption from U.S. taxes that you will be in for some lawsuits. I just wanted to figure out a way to avoid that.

Mr. HANSELL. That would not be a lawsuit that I would want to undertake on their behalf, but we will find a way to avoid this.

Senator STONE. You would not undertake this on a contingency basis then? That is really not much of a lawsuit. Thank you, gentlemen.

Senator PELL. The committee will recess until 2 o'clock this afternoon.

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Supreme Court, U.S.
FILED
DEC 27 1985
JOSEPH F. SPANIOL, JR.
CLERK

IN THE

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OCTOBER TERM, 1985

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Petitions for Writs of Certiorari to the United States Court of Appeals for the Federal Circuit

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PETITIONERS' REPLY TO RESPONDENT'S REPLY BRIEF

ANDREW C. BARNARD
BARNARD, P.A.
9769 South Dixie Highway
Suite 201
Miami Florida 33156
(305) 665-0000

Counsel for Petitioners Coplin

ALLAN I. MENDELSOHN
MARVIN L. SZYMKOWICZ
WARD & MENDELSOHN, P.C.
1100 17th Street, N.W.
Suite 900
Washington, D.C. 20036
(202) 785-0200
Counsel for Petitioners O'Connor

JOHN C. MORRISON
KIEFFER & MORRISON
200 North Fairfax Street
Alexandria, Virginia 22314
(703) 549-8844
Counsel for Petitioners Mattox

PRESS OF BYRON S. ADAMS, WASHINGTON, D.C. (202) 347-8203

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PETITIONERS' REPLY TO RESPONDENT'S REPLY BRIEF

Petitioners respectfully respond to the United States' brief filed on December 3, 1985. The Government's Statement of the case is misleading. If the case were as simplistic as the Government suggests, neither the unanimous panel of the Eleventh Circuit (in *Harris*) nor Chief Judge Kozinski of the Claims Court (in *Coplin*) would have reached the results they did. On the other hand, because the Government joined Petitioners in requesting that certiorari be granted, no need is usefully served by responding to the Government's brief point by point.

Respectfully submitted,

ANDREW C. BARNARD, ESQ.
BARNARD, P.A.
9769 South Dixie Highway
Suite 201
Miami, Florida 33156
(305) 665-0000

Counsel for Paul H. Coplin and Patricia Coplin

Of Counsel:

DWIGHT A. MCKABNEY
Apartado 3116
Balboa-Ancon
Republic of Panama

ALLAN I. MENDELSOHN
MARVIN L. SZYMKOWICZ
WARD & MENDELSOHN, P.C.
1100—17th Street, N.W.
Suite 900
Washington, D.C. 20036
(202) 785-0200

Counsel for Robert E. O'Connor and Gladys E. O'Connor

JOHN C. MORRISON
2000 N. Fairfax
Alexandria, Virginia 22314
(703) 893-5551
Counsel for Jack R. Mattox and Maria Mattox

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No. 85-558

IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

ROBERT E. O'CONNOR AND GLADYS E. O'CONNOR,
Petitioners,

v.

UNITED STATES OF AMERICA,
Respondent.

On Writ Of Certiorari To The United States Court Of Appeals For The Federal Circuit

BRIEF FOR PETITIONERS

ALLAN I. MENDELSOHN
Counsel of Record
MARVIN L. SZYMKOWICZ
WARD & MENDELSOHN, P.C.
1100 17th Street, N.W.
Suite 900
Washington, D.C. 20036
(202) 785-0200
Counsel for Petitioners

Of Counsel
DWIGHT A. MCKABNEY
Apartado 3116
Balboa-Ancon
Republic of Panama
011-507-63-5316

PRESS OF BYRON S. ADAMS, WASHINGTON, D.C. (202) 347-8203

58 pp

QUESTIONS PRESENTED

1. Whether United States citizen employees of the Panama Canal Commission (PCC) are exempt from taxation by the United States on their PCC salaries under Article XV(2) of the Agreement in Implementation of the 1977 Panama Canal Treaty which, by its terms, exempts such employees

> "from any taxes, fees, or other charges on income received as a result of their work for the Commission."

2. Whether diplomatic correspondence may be introduced by the Government immediately before oral argument in the court of appeals where the Government is itself the litigant and where it repeatedly refused the trial court's urgings to obtain and introduce such matters below.

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On Writ Of Certiorari To The United States Court Of Appeals For The Federal Circuit

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BRIEF FOR PETITIONERS

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Federal Circuit is reported at 761 F.2d 688 (Pet. App. 1a-8a).[1] That opinion, which reversed the decision of the

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[1] References to material in the Petitioners' Appendix will be in the form: "Pet. App. ___". By Order entered February 24, 1986, this Court granted a Motion by Petitioners to dispense with the printing of a joint appendix. References in this Brief to the record below will be to the two volume Joint Appendix prepared for use in the United States Court of Appeals for the Federal Circuit, 10 copies of which

United States Claims Court, reported at 6 Cl.Ct. 115 (1984) (Pet. App. 9a-69a), is in direct conflict with the opinion of the United States Court of Appeals for the Eleventh Circuit in *Harris* v. *United States*, reported at 768 F.2d 1240 (1985) (Pet. App. 72a-86a), petition for certiorari pending.

JURISDICTION

The judgment of the Court of Appeals was entered May 10, 1985. A petition for rehearing was denied on July 3, 1985 (Pet. App. 70a-71a). The petition for a writ of certiorari, filed September 30, 1985, was granted by this Court on January 13, 1986. The jurisdiction of the Court is invoked under 28 U.S.C. §1254(1).

TREATY, EXECUTIVE AGREEMENT, AND STATUTE INVOLVED

Panama Canal Treaty between the United States of America and the Republic of Panama, September 7, 1977, T.I.A.S. No. 10030:

Article III

Canal Operation and Management

* * * * *

9. The use of the areas, waters and installations with respect to which the United States of America is granted rights pursuant to this Article, and the rights and legal status of the United States Govern-

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have been lodged with this Court by the Respondent. Reference to that appendix will be in the form: "App. ___". References to material in the Appendix to the U.S. Government's Brief, filed on December 3, 1985, acquiescing in the Petitions for Certiorari will be in the form: "U.S. App. ___".

ment agencies and employees operating in the Republic of Panama pursuant to this Article, shall be governed by the Agreement in Implementation of this Article signed this date.

Agreement in Implementation of Article III of the Panama Canal Treaty, September 7, 1977, T.I.A.S. No. 10031:

Article XV

Taxation

* * * * *

2. United States citizen employees and dependents shall be exempt from any taxes, fees, or other charges on income received as a result of their work for the Commission. Similarly, they shall be exempt from payment of taxes, fees or other charges on income derived from sources outside the Republic of Panama.

United States Code, Title 26, Section 894(a):

Income exempt under treaty.—Income of any kind, to the extent required by any treaty obligation of the United States, shall not be included in gross income and shall be exempt from taxation under this subtitle.

STATEMENT OF THE CASE

A. The Issue In Dispute: Historical Background Of The 1977 Treaty

On September 7, 1977, the United States and the Republic of Panama signed the Panama Canal Treaty of 1977. Article III of that Treaty provided that the "rights and legal status of United States Government agencies and employees operating in the Republic of Panama" shall be governed by a separate executive agreement titled "Agree-

ment in Implementation of Article III of the Panama Canal Treaty of 1977" (hereafter "the Implementation Agreement"). The Implementation Agreement was signed on the same day as the Treaty.[2] The basic issue before the Court involves the interpretation of one provision of that Agreement—Article XV(2), which states that U.S. citizens employed by the Panama Canal Commission (hereafter "the Commission") "shall be exempt from any taxes, fees, or other charges on income received as a result of their work for the Commission".

The 1977 Treaty supplanted the earlier Canal treaties of 1903, 1936, and 1955.[3] The 1903 Treaty ceded to the United States in perpetuity exclusive sovereign rights over the area that was called the Canal Zone. During the subsequent 74 years, Panama's dissatisfaction with that grant of sovereignty was said to be the reason for its recurring and increasingly acrimonious protests against the U.S. presence there. Throughout those 74 years, Panama's aspirations for eventual recovery of sovereignty over the Canal Zone were the fundamental irritant in her relations with this country.

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[2] The Treaty appears at T.I.A.S. 10030. The Implementation Agreement appears at T.I.A.S. 10031. A separate Implementation Agreement, covering military personnel and implementing Article IV of the Treaty, appears at T.I.A.S. 10032. No issue is raised here as to any difference in status between the Treaty and the Implementation Agreements. When the Senate was considering both documents as part of the advice and consent process, then State Department Deputy Legal Advisor, Mark Feldman, testified before the Senate Foreign Relation Committee that the Agreements "are an integral part of the treaty" and that "by giving its advice and consent to the treaties", [the Senate] authorizes the entry and brings into force those Agreements". Senate Hearings on the Panama Canal Treaty Before the Committee on Foreign Relations, 95th Cong., Pt. V, 1st Sess. (1977) at 117-121 (hereafter cited as "Hearings").

[3] Isthmian Canal Convention, November 18, 1903, 33 Stat. 2234, T.S. No. 431; General Treaty of Friendship & Cooperation, March 2, 1936, 53 Stat. 1807, T.S. 945; Treaty of Mutual Understanding & Cooperation, January 25, 1955, T.I.A.S. 3297, 6 UST 2273.

After the final phase of their negotiation of the 1977 Treaty, U.S. Ambassadors Ellsworth Bunker and Sol Linowitz testified at hearings conducted by the Senate Foreign Relations Committee. On September 26, 1977, Ambassador Linowitz described the treaty history of the Panama Canal as follows:

> "[The 1903 Canal Treaty] granted the United States rights in perpetuity to construct a canal within a zone 10 miles wide over which the United States would exercise, as the treaty says, the rights, power, and authority it would have if it were the sovereign.
>
> "Secretary of State Hay, who signed the treaty, candidly wrote to a leading Senator that the treaty was, in his words, and I quote, 'very satisfactory, vastly advantageous to the United States and, we must confess, with what face we can muster, not so advantageous for Panama'. The treaty was ratified in 1904, and construction of the canal was begun immediately. It was completed in 1914, after a brilliant engineering and scientific performance by American engineers, doctors, scientists, and builders who were determined to conquer the unconquerable and make the canal a reality.
>
> * * *
>
> "Now, while the canal has been a source of deep understandable pride to the United States, it has been a troubling and festering presence in Panama. Under the treaty, the United States established jurisdiction over the Canal Zone courts. It has established the zone's schools, jails, and its police force. It has set up what the Panamanians have regarded as a colonial enclave splitting their country in two and using 550 square miles of their best land, and the Panamanians have made known their resentment at the United

> States having done so pursuant to a treaty which was not even signed by a Panamanian."[4]

In a constituent newsletter, Senator Hollings described the U.S. role as follows:

> "There is no question, the United States rooked Panama back in 1903. We actively supported the revolution against Colombia by its Isthmus section after Colombia refused to ratify the treaty we wanted. We sent ships and troops and this guaranteed the outcome. Then we signed the treaty hurriedly before the official delegation objecting from Panama could even arrive in Washington. Signing for Panama was—not a Panamanian—but a French citizen who had not been in Panama for 17 years, and who returned to France immediately after the ratification."[5]

Secretary of State Cyrus Vance, also testifying in support of the Treaty, was asked whether Senator Hollings' historical summary was "generally on all fours with the understanding that you gentlemen have of how we got into this situation". He replied that it indeed "was generally on all fours with our understanding as to how we got into it".[6] The 1977 Treaty was the culmination of negotiations that began in 1964. In that year, as then Senate Foreign Relations Committee Chairman Sparkman observed, "rioting broke out in Panama and diplomatic relations were broken". President Johnson dispatched his then special envoy, Cyrus Vance, to the Canal Zone. In the aftermath of those events, based upon Mr. Vance's recommendations, President Johnson began to negotiate a new agreement with Panama on the canal. Each President since President Johnson, as Secretary Vance added, "has

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[4] Hearings, Part I at 20-21.

[5] *Id.* at 51.

[6] *Id.*

believed that it was essential to negotiate a new treaty and to put our relationship with Panama on a new and sounder footing".[7] In testifying about the final result of these negotiations, Secretary Vance stated that the new Treaty removed "one of the most difficult and exacerbating issues . . . and that is the issue with respect to how the U.S.'s presence will be handled there and the question of the Canal Zone itself and the question of sovereignty.[8]

It is against the background of those reports by high officials in the United States Government that the disputed provision of this international agreement should be viewed.

B. The Treaty Negotiations On The Subject Of Taxation

1. Background

Between the years 1921 and 1951, the salaries received by U.S. citizen employees of the Panama Canal, the Canal Zone Government, and other Federal agencies in the Canal Zone were effectively exempt from taxation by the U.S. Government. See §251, Internal Revenue Code of 1939 (prior to enactment of §220 of Revenue Act of 1950). Section 251 conferred a total tax exemption with respect to Panama Canal salaries paid to the U.S. citizen taxpayers—unless the taxpayer had substantial non-Panama source income (pursuant to a formula defined in §251). It may safely be said that most, if not all, of the salaried employees of the federal government working for the Panama Canal regularly qualified for the exemption. Beginning in 1951, their Panama Canal income became subject to taxation under amended §251 (i.e., §931(h) of the 1954 Code).

Notwithstanding the comparatively modest contribution to the Federal fisc made by this small group of American

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[7] *Id.* at 54.

[8] *Id.* at 37.

taxpayers—numbering 1,895 in 1980 and 1,360 in 1985[9]—the question of the right to tax them was the subject of considerable dispute during the Treaty negotiations. It was also among the very last issues to be resolved. As of June 24, 1977, Secretary of State Vance advised that all other Treaty questions had been settled and that the matter of "economic arrangements" (which included the tax issue) was "the major remaining issue relating to the Canal negotiations" (App. 163).

2. The Panamanian Position in the Negotiations

Negotiations on the taxation issue were strained and, at times, contentious. Both the United States and Panama claimed the right to tax the U.S. citizen employees. Panama viewed that right as an essential attribute of its restored sovereignty over the Canal Zone. As a sovereign, it had the right to tax income earned in and from its territory. Consistent with that view, the Panamanian negotiating team proposed the direct imposition of Panamanian taxation on all Americans employed by the Panama Canal Commission. *See* Kozak affidavit (App. 89). On July 11, 1977, Minister Aristides Royo, a member of the Panamanian negotiating team, summarized Panama's position as follows (App. 120-21):

> "Also, in another paper that we submitted to you, we brought out the need for U.S. citizen employees who worked for the entity [i.e., the Panama Canal Commission], which will be operating the Canal after the treaty, to pay income tax to Panama, and the reason is very simple. These employees, despite the fact that they are United States nationals, are employees who are working outside the United States and in territory that will not be subject to the jurisdiction of the United States, and their salaries will be generated

[9] Annual Report, Panama Canal Commission, Fiscal Year 1980, p. 21; Govt. Brief Acquiescing in Certiorari Petitions, at 12

not from U.S. Treasury funds, but from the activities involved in operating the Canal; and accordingly, and furthermore, because these persons, as you know and as we have already agreed, have the right of free movement throughout the breadth of our country, and will receive all due attention from us in every respect whether it is hospitals, social matters, or travel in our country, these are people that ought to pay our country, as do the remainder of those citizens and persons working on our soil, that they should pay income tax. You said that you were going to study this problem, and we are again hoping for a positive response from you in order to arrive at the conclusion of a treaty between our two countries."[10]

While insisting on its own right to tax, Panama was not inflexible on the issue of whether the U.S. could also tax. Thus, during an earlier session, on June 30, 1977, Mr. Royo suggested a division of tax revenues (App. 117):

"So on the basis of that credit, the tax credit, on the basis of that difference that could be provided to determine the difference with the Panamanian taxes, which are lower—the United States would receive a part of the tax and we would be receiving the other part. And in that way we would get all of the amount we expect from the income tax—this might be a formula that might be found to be satisfactory.

"We will be willing to provide additional information later on, on this topic."

3. The U.S. Government's Position In the Negotiations

The U.S. negotiating position was stated by Ambassador Linowitz during the session of June 30, 1977. He in no

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[10] The State Department has never released that "another paper" referred to by Mr. Royo in his first sentence as having previously been "submitted" to the U.S. Government.

way took issue with Panama's claim of right to tax based upon territorial sovereignty. Rather, he indicated that the U.S. objected to the Panamanian proposal because depriving the U.S. of the right to tax would mean a loss of revenue for the U.S. Treasury. His statement was (App. 117):

> "Then it would be a cost to the United States. That is the point. What you are saying is: it would not be an additional charge on the employees, but would represent a loss to the United States of taxes that would otherwise be paid in the United States. That's what you are saying, aren't you?"

Ambassador Linowitz indicated that the U.S. would study the issue and let the Panamanians "know what further work we have done" (App. 116).

4. The U.S. Government's In-House Position

In contrast to what they told the Panamanians, the American negotiating team held a different view. They considered the potential loss of revenue not to be significant. By means of a U.S. Treasury Department memorandum entitled "Rebating to Panama U.S. Income Tax on Canal Zone Taxpayers" (App. 159), the U.S. representatives were informed that only a modest amount of tax revenue was involved. The memorandum, which was dated June 29, 1977 and prepared for the discussion of tax and revenue issues at the 21st round of the negotiations, reported that Americans residing in the Canal Zone paid little or no taxes and the total of lost revenue would be about $600,000.

In a State Department memorandum from Secretary Vance to the Panama Review Committee, it was estimated that, by taxing the U.S. employees, Panama would realize revenues of "not more than $3 million per year". *See* Memorandum, July 19, 1977 (App. 151-52). At a later point, the State Department estimated that Panama "would re-

alize only $2-3 million per year" from taxing these employees, but that this would "set a bad precedent" (App. 164). The Department was also concerned that this "would be the type of issue which treaty opponents could use to considerable advantage" (App. 162).

As noted in a Department briefing paper of July 8, 1977 (App. 130), the American team recognized that the tax dispute was a matter principally of sovereignty, not of revenue:

> Panama may be raising this as an issue to assert its 'sovereign right' to tax persons resident within its jurisdiction. The money involved is not important to the GOP [Government of Panama], but the principle is. At current Panamanian tax rates, tax payments by U.S. employees would total approximately $2 million per annum (average U.S. employee taxable income is $11,000 plus). . . . . [remainder of paragraph still classified] A concession to Panama on this issue could result in demands from other countries for similar treatment."

Consistent with this view, the U.S. team also rejected still another Panamanian suggestion, advanced about July 19, 1977, that Panama not tax U.S. employees until "three years after entry into force of the treaty" (App. 128, 151-152, 154).[11]

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[11] Two Confidential Memoranda prepared by then Secretary of State Vance sometime around July 19, 1977, put the issue in these terms (App. 151-152, 164):

> Panama has proposed that effective three years after entry into force of the treaty the United States citizens employed by the Canal Administration pay income taxes to Panama on their salaries and other income collected in Panama. It estimates these taxes at $7-10 million a year.
>
> While we have told Panama that it would be most difficult for the United States to acquiesce to Panamanian taxation of its U.S. citizen employees, we *could* do so if we chose. However, United

C. The Gaps In The Negotiation Record

The Department of State represented to the Claims Court that, after July 18, 1977, there is no contemporaneous record of any of the negotiations on the issue of taxing the U.S. citizen employees. *Coplin*, *supra* (Pet. App. 28a-29a, 34a). Accordingly, with minor exceptions (e.g., App. 161-62), there is no record of the position papers or discussions within the U.S. team, nor any information showing how the language of Article XV was proposed, discussed or adopted. Nevertheless, when the treaty negotiations ended in August 1977, the language of paragraph 2 of Article XV somehow had reconciled the sharply conflicting objectives of the two nations.

It is clear that, however the dispute was resolved, it was done in haste. As late as the session of July 11, the American negotiators still had not given the Panamanians a paper showing the U.S. position in writing (App. 126-27):

> MINISTER ROYO: Do you have anything on income tax?
>
> AMBASSADOR BUNKER: Yes.
>
> MR. WYROUGH [a U.S. negotiator]: Yes, we do.
>
> AMBASSADOR LINOWITZ: We don't have a paper. [. . . here a half page of the classified document was deleted . . .] Now, on the income-tax question we do not have a paper. . . . . we have no authority to accede to your request on this score.

Similarly, as of July 18, the U.S. had still not given Panama the text of a proposed Article XV but, instead,

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States Government employees are exempted from host country income taxes throughout the world. Making Panama an exception would set a bad precedent for U.S. Government operations in other foreign countries. Secondly, we estimate that revenue generated from such taxation would amount to not more than $3 million per year (emphasis in original).

was merely referring orally to a provision in the Status of Forces Agreement (i.e., Article XVI of what became the Agreement in Implementation of Article IV of the 1977 Treaty) (App. 156, 158, 178). Even as late as the date of the State Department's secret cable of August 3, 1977, the matter was still unresolved (App. 99, 166). Yet, within the next two to three weeks, the negotiations were concluded. On September 7, 1977, the Treaty was signed.

D. The Failure Of The Government To Seek Clarification Before Ratification Of The Treaty

By September 21, 1977, attorneys in the Treasury Department realized that Article XV(2) would create an exemption from United States, as well as Panamanian, taxes (App. 58-59). They recommended that the language be clarified. Their recommendation was not acted upon. Later, during hearings before the Senate Foreign Relations Committee, Senator Stone raised the same question—referring to what he described as the "glee" shown by Canal Zone residents who also had read Article XV(2) as exempting their salaries from taxation. The Senator questioned the State Department's Legal Advisor, Mr. Herbert Hansell, as to whether the language should be clarified if an exemption was not intended. Mr. Hansell replied that something would be done (Hearings, Part I at 268-269) (U.S. App. 10a-12a). The record is devoid of evidence that anything was ever done by the Government prior to February 1985.

E. The Differing Panamanian Explanations As To What Happened In August 1977

1. The Initial Panamanian Views

There is evidence showing the meaning given by certain Panamanian representatives to the phrase "exempt from any taxes". By correspondence dated December 13, 1983, Mr. Demetrio B. Lakas, a former President of Panama, and Mr. Juan Antonio Tack, a former Minister of Foreign

Relations of Panama, both stated their views that Article XV(2) was intended to create a [illegible]onal tax exemption (App. 188, 190).

Similarly, in an affidavit executed on March 2, 1984, one of Panama's principal treaty negotiators, Dr. Carlos Lopez-Guevara, stated that only during the last negotiation session sometime in August did the U.S. for the first time provide to Panama a written proposal for the text of Article XV (App. 192-93). Lopez-Guevara further stated that paragraph 2 of Article XV was viewed by Panama as compelling "both Panama and the United States of America not to tax United States citizens by reason of their work with the Panama Canal Commission".

2. The U.S. Government Declines to Obtain Views From the Panamanian Government

During February and March 1984, when this case was before the Claims Court and the views of Messrs. Lakas, Tack and Lopez-Guevara were already matters of public record, the Claims Court made a determined effort to ascertain whether the U.S. Government could or would obtain a view on the issue from the Panamanian Government. On February 23, 1984, after expressing some scepticism as to the persuasiveness of the U.S. Government's asserted position, the Claims Court continued the case for two weeks to give the Government an opportunity "to consider supplementing the record by obtaining an indication from Panama as to its intentions in agreeing to the language of Article XV" (Pet. App. 64a). Thereafter, and as described in the Court's opinion (*Id.*):

> "At the next hearing on the matter, [Government] counsel informed the court that no clarification would be requested or obtained from Panama (Mar. 8 Transcript at 3, 8). The court then took the unusual step of inviting an appearance by a more senior attorney to ensure that the implications of this decision were fully understood and appreciated by [the Government].

> [Government] counsel and her supervisor [Mr. Peyser] appeared at a hearing later the same day and the court once again stated that it found plaintiff's presentation persuasive but urged [the Government] to supplement the record by obtaining clarification from Panama or through some other means. *Id.* at 26-27, 39-40, 43-45, 49-50. Despite numerous statements by the court that it would decide the case in favor of plaintiff on the record as presented, [the Government] steadfastly refused the opportunity to supplement the record."

Government counsel specifically represented to the Court, during the March 8, 1984 hearing, that the United States did not think "the opinion of any official in Panama in 1984 is persuasive".[12]

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[12] A portion of the court's colloquy with Government counsel is reprinted below (Transcript, pp. 43-47, March 8, 1984):

> Court: I am giving you the opportunity to obtain from Panama their understanding as to the meaning of this provision. That is what I gave your attorney two weeks ago. It is done all the time for one Government to get a diplomatic note from another Government saying we had a Treaty provision and this is what it means. If you don't want to get it, I will draw whatever inferences can be drawn from the refusal to obtain that.
>
> Mr. Peyser: I think the case should be decided on the materials before the Court.
>
> Court: So I am going to ask you one more time, Mr. Peyser, do you wish to take advantage of the opportunity to supplement the record by obtaining a clarification of Panama's understanding of the Treaty language? If you wish, have a few days or a week to go back and check on that. I will give it to you, but I want a concise and clear yes or no answer from the United States.
>
> Mr. Peyser: No. No., your Honor.
>
> • • • • •
>
> Mr. Peyser: I don't [think] the opinion of any official in Panama

3. The U.S. Government Gives Panama An "Historic" $30 Million Direct Grant Of Aid and Obtains the Views of the Panamanian Government

On December 24, 1984, the U.S. Government gave Panama a direct grant in aid of $30 million. U.S. Ambassador to Panama, Everett Briggs, was reported as having described the grant as "historic" because it was the first time the U.S. had ever made such a direct grant to Panama. (Annex C to Motion by Appellees to Strike, filed March 4, 1985.)

On Thursday, February 28, 1985, one working day prior to oral argument in the Federal Circuit on Monday, March 4, 1985, the Government filed its reply brief. Without prior notice, the Government attached to its reply brief three nearly identical letters from former Panamanian officials who were members of the Panamanian negotiating team. These letters, which were accompanied by a transmittal note from then Panama Foreign Minister Fernando Cardoze, stated that the provision in issue was "drafted exclusively with respect to the tax exemption that the Republic of Panama would grant to U.S. citizen employees" and "resulted from negotiations which did not deal

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in 1984 is persuasive.

Court: . . . All I can gather is that you don't think you are going to get from Panama the interpretation that you want.

Mr. Peyser: I have no idea what the response would be from Panama.

Court: Well, would you like to go find out?

Mr. Peyser: I decline the invitation to do that. I understand you are asking if we would like to do that, and the answer is, no. I don't think it would be appropriate or necessary.

with the United States authority to tax the individuals mentioned therein" (U.S. App. 4a-9a).[13]

F. The United States View

The gist of the United States position in the courts below has been that, notwithstanding the continued sharp differences between the two nations on the issue of whether Panama enjoyed the sovereign right to tax, the Panamanians simply capitulated, withdrew their claim of a sovereign right to tax, and agreed that only the United States could assess such taxes. Regarding the views expressed by Messrs. Lakas, Tack and Lopez-Guevara, the United States argued below that this "simply is an opinion after the fact. It's not contemporaneous. It was prepared in preparation of this lawsuit" (Transcript, Feb. 13, 1984 at 26).[14]

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[13] On March 4, 1985, shortly preceding oral agrument, the taxpayers moved unsuccessfully to strike the correspondence from the record, arguing that they had had no opportunity to inquire into the provenance of the correspondence or its validity. At issue was the peculiar nature of the letters themselves plus the fact that the authors of two of the letters did not state that they participated at all in the Article XV(2) negotiations, and the author of the third letter claimed to have had a role only in the negotiation of Article XVI(2) of the Article IV Implementing Agreement. In addition (and as is more fully discussed below at pp. 40-42), former Panama Foreign Minister Fernando Cardoze had earlier expressed a contrary official view to the effect that U.S. citizens enjoyed a binational exemption under Article XV(2).

[14] In various district counts that ruled for the Government in similar cases brought prior to the litigation below, the Government introduced into evidence an affidavit of a Mr. Michael Kozak who is now a State Department Deputy Legal Advisor. In 1977, Mr. Kozak was a member of the U.S. team negotiating the Treaty, but "was not privy to the actual negotiations on the tax exemption issue". *Harris* v. *United States* (Pet. App. 82). Mr. Kozak's affidavit (App. 87-90) concluded that Article XV was intended to create an exemption only from the payment of Panamanian taxes. Although various of the district courts that had earlier ruled for the Government relied principally on Mr. Kozak's affidavit, the Government in the Claims Court below conceded that Mr.

G. The Principal, Relevant Provisions Of The 1977 Treaty

The Treaty was ratified by President Carter on June 15 and by Panama on June 16, 1978. It entered into force on October 1, 1979 and will terminate on December 31, 1999. Article III(1) recognizes Panama as the "territorial sovereign" and grants the United States the "rights to manage, operate, and maintain the Panama Canal, its complementary works, installations and equipment and to provide for the orderly transit of vessels . . .". Article III(3) provides for the creation of a Panama Canal Commission by means of which the two countries are to carry out their responsibilities under the Treaty.

Although the Commission is constituted under Federal law and is denominated as a U.S. Government agency, the Treaty requires that it be managed by a binational supervisory board. Five of the board members are Americans. The other four must be Panamanians who are nominated by the Government of Panama and cannot be removed without Panama's consent. The two executive officials of the Commission are an Administrator and a Deputy Administrator. Until 1990, only the Deputy need be Panamanian (nominated by his government). Thereafter, until the treaty expires, the Administrator must be a Panamanian and the Deputy an American. Article III(8) provides that there shall be a growing participation of Panamanian nationals at all other levels and areas of employment in the Commission. Finally, Article X(3) requires the United States, within the first five years after the Treaty enters into force, to reduce the number of U.S. citizen employees by 20%.

Kozak's affidavit "may not be used to divine the purpose of Article XV" (Pet. App. 35a, n. 16). The Government later disavowed Mr. Kozak's affidavit presumably because the Government could not consistently argue that Mr. Kozak's affidavit was probative while saying that Mr. Lopez-Guevara's affidavit was nothing more than "an opinion after the fact . . . prepared in preparation of this lawsuit".

The treaty and related agreements also contain substantial economic benefits and concessions for Panama. The United States agreed to pay from Canal operations four separate annuities, three of which would be fixed and one that would be based upon, and vary with, the amount of vessel traffic passing through the Canal. The value of these Canal annuities was estimated in 1978 at from $50 to $90 million per year for the duration of the Treaty. There were also undertakings by the United States to extend housing investment guarantees up to $75 million; loans, loan guarantees, and insurance up to $200 million through the Export-Import Bank; and $50 million in repayment guarantees under the foreign military sales program to facilitate the purchase by Panama of defense articles and services. Article XIII provides that upon termination of the Treaty, the Panama Canal shall be given to the Republic of Panama in operating condition and free of liens and debts. The estimated replacement value of property that has been or will be given to Panama is $8 billion. *See* S. Exec. Rep. No. 95-12, 95th Cong., 2nd Sess., 1978, at 91 et seq.; Exchange of Notes between Panama and the U.S., September 7, 1977.

H. Procedural Posture Of Litigation

Petitioner Robert O'Connor is a U.S. citizen employee of the Panama Canal Commission. The O'Connors paid their income taxes for the year 1980 and then sued for refund in the Claims Court based on the Article XV(2) exemption. On July 30, 1984, the Claims Court (Chief Judge Kozinski) entered summary judgment in the *Coplin* case (Pet. App. 9a) and separate judgments for the O'Connors and Mr. and Mrs. Jack Mattox, all of which cases are consolidated herein. In addition, the Claims Court suspended action on all pending Article XV(2) refund suits until the outcome of *Coplin*. There are now more than 200 taxpayer suits pending in the Claims Court, awaiting the outcome of this appeal.

The Government appealed the Claims Court action to the U.S. Court of Appeals for the Federal Circuit. By opinions entered on May 10, 1985, the Federal Circuit reversed the Claims Court. Writing for the five-member panel, Judge Bissell concluded that, in view of the "letters from the Panamanian team that negotiated the Implementation Agreement"(Pet. App. 7a):

> "[T]he record now reveals the intent of each government. Since both treaty parties agree that paragraph 2 was not intended to create an exemption from United States domestic taxation, the trial court's decision cannot be upheld."

The opinion held that the letters could properly be received into evidence because of the court's power to take judicial notice of "the public acts and proclamations of (foreign) governments" (Pet. App. 6a). In a concurring opinion of Judge Nies, in which Judges Rich and Baldwin joined, the court concluded that it was not necessary to consider the evidence provided by the diplomatic correspondence, inasmuch as the words "by the Republic of Panama" should simply be inserted into the title of Article XV—even though, as drafted, that title is simply "Taxation" (Pet App. 8a).

Mr. and Mrs. Ralph Harris, also U.S. citizen employees of the Commission, filed a similar refund suit in the U.S. District Court for the Southern District of Georgia, seeking a refund of $6,647.00 for taxes paid on 1979 income. On March 21, 1984, Judge Dudley H. Bowen entered judgment for the Harrises on the basis that Article XV(2) is "needful of no interpretation. It says what is says." 585 F.Supp. 862, 863. The Government appealed Judge Bowen's decision to the U.S. Court of Appeals for the Eleventh Circuit. As it did in the Claims Court, the Government submitted the three letters to the Eleventh Circuit. On August 14, 1985, a unanimous panel of the Eleventh Circuit affirmed Judge Bowen (Pet. App. 72a-86a). The Court considered

the Federal Circuit's decision in *Coplin* and declined to follow it. The Court rejected the Government's "suggestion that self-serving evidence outside the record [i.e., the three letters], for which additional explanation is required, can be considered by this Court". In any case, so the Court added, a full reading of the Treaty and the available legislative history compels the conclusion that " 'exempt from any taxes' meant just that" (Pet. App. 76a, 79a). The Government's petition for certiorari is presently pending disposition (No. 85-1011).

SUMMARY OF ARGUMENT

1. It was error for the Federal Circuit to accept and consider on the merits the diplomatic correspondence obtained by the United States on the eve of oral argument below. The Claims Court had earlier entreated counsel for the United States to secure a statement from the Government of Panama of its interpretation of Article XV(2). The United States refused, representing that it would not be "appropriate or necessary" to do so. Its contradictory position before the Federal Circuit created a judicial estoppel against introduction of the material.

The doctrine of judicial estoppel prohibits litigants from taking inconsistent positions before different Courts with respect to the same set of facts. It is meant to protect Courts and litigants from parties that would otherwise vary and contradict themselves where expediency dictates. In the instant case, the application of judicial estoppel also would have the salutary effect here of preventing the United States from using diplomacy to influence the outcome of domestic litigation.

The late introduction of the diplomatic correspondence should also have been barred by the prohibition on supplementing the trial record on appeal. By considering the new material and treating it as conclusive on the question of the intent of the Panamanian negotiating team, the

Federal Circuit deprived the O'Connors and their co-petitioners of an opportunity to develop a proper adversary trial record on the diplomatic correspondence.

2. Article XV(2) must be construed according to the rule that the plain meaning of a legal instrument is normally controlling. The language of Article XV(2), on its face, creates an exemption from "any taxes". By contrast, other provisions of the Treaty documents specifically define rights and obligations that are to apply to Panama alone. Similar agreements between the United States and foreign governments specifically define the circumstances under which only the host country is prohibited from imposing taxes. Article XV(2)'s radical departure from this established patttern of international agreements confirms that it was intended to be a binational exemption.

In July 1984, at a meeting of the PCC supervisory board, Panamanian members of the board expressed the official view that Article XV(2) exempted U.S. citizen employees from U.S. income taxation. Those members were then Foreign Minister of Panama Ortega and soon to become Foreign Minister Cardoze. Dr. Cardoze was the same individual who, a few months later, would sign the diplomatic correspondence submitted to the Federal Circuit. That court committed reversible error in refusing to consider the transcript of the board meeting tendered in the O'Connors' petition for rehearing.

This Court's case law on treaty interpretation supports a plain meaning reading of the term "any taxes" as creating a binational exemption. No case relied upon by the United States in the proceedings below sanctions a departure from the plain meaning of a provision where there is no ambiguity in the treaty or related documents.

The history of the Article XV(2) negotiations confirms the plain meaning interpretation. The final Article XV(2) language was presented for the first time in August 1977, shorn of its earlier references to taxation "as provided by

Panamanian law". It was accepted by both countries as a compromise formulation under which neither nation would tax. Such a result accommodated the objectives of both countries: the U.S. did not wish Panama to tax the income of American citizens whom the U.S. viewed as employees of a U.S. agency; and Panama did not wish to allow the U.S. to assert the sovereign right to tax individuals who were residing in Panama and employed by a binational enterprise.

ARGUMENT

I. The Appellate Level Introduction Of Diplomatic Correspondence Was Precluded By The Doctrine Of Judicial Estoppel And The Normal Prohibition On Supplementation Of The Trial Record On Appeal

A. The Government's Representations To The Claims Court That It Would Be Improper And Unnecessary To Seek A Diplomatic Note From Panama Judicially Estopped It From Presenting Such A Note To The Federal Circuit

As related in the O'Connors' statement of the case, the Claims Court repeatedly asked the United States to supplement the trial record with a statement from the Government of Panama. The United States "decline[d]" the Court's invitation, stating that, coming in 1984, such a statement would not be "persuasive" on the merits and that the process of soliciting it would not be "appropriate or necessary".

The United States specifically requested that the Claims Court decide the action based on the "materials before it" and agreed to the Claims Court approach of not relying on any of the post-negotiation statements of either of the contracting nations (Pet. App. 35a-36a, n. 16). As a result, the Claims Court analysis was based on the Treaty language and the negotiating transcripts.

The representations to the Claims Court by the United States created a judicial estoppel that should have barred

any appellate consideration by the Federal Circuit of the diplomatic correspondence. The Court's reliance on the correspondence was reversible error.

1. The doctrine of judicial estoppel prohibits a party from advancing inconsistent positions with respect to the same facts before different courts. *Himel* v. *Continental Ill. Natl. Bank*, 596 F.2d 205, 210-211 (7th Cir. 1979); *In re Yarn Processing Patent Validity Litigation*, 498 F.2d 271, 279 (5th Cir. 1974), *cert. denied* 419 U.S. 1057, 95 S.Ct. 640, 42 L.Ed.2d 654 (1974). The doctrine prevents litigants from "playing 'fast and loose' " (*Scarano* v. *Central R. R.*, 203 F.2d 510, 513 (3d Cir. 1953)), or "blow(ing) hot and cold" (*Ronson Corp.* v. *Aktiengesellschaft*, 375 F.Supp. 628, 630 (S.D.N.Y.1974)) with the courts. Its purpose is to "protect the integrity of the courts and the judicial process" from litigants who would seize upon any expedient to advance their case. *United Virginia Bank* v. *Saul Real Estate*, 641 F.2d 185, 190 (4th Cir. 1981), quoting from *Duplan Corp.* v. *Deering Milliken, Inc.*, 397 F.Supp. 1146, 1177-1179 (D.S.C. 1975). See also *Bower* v. *O'Hara*, 759 F.2d 1117 (3rd. Cir. 1985); *Donovan* v. *United States Postal Service*, 530 F.Supp. 894 (D.D.C. 1981).[15]

Although judicial estoppel is not yet a universal doctrine, it has been approved in dicta by this Court. See *Huffman* v. *Pursue, Ltd.*, 420 U.S. 592, 606 n. 18, 95 S.Ct. 1200, 1209 n.18, 43 L.Ed.2d 482 (1975). The doctrine has also been endorsed by most United States Courts of Appeal (see *supra*) and an increasing number of state courts. See, for example, *Associated Hospital Service* v. *Pustilnik*, 497 Pa. 221, 227, 439 A.2d 1149, 1151 (1981); *Mecham* v. *City*

[15] Cf. also *Hohri* v. *United States*, 782 F.2d 227 (D.C.Cir. 1986) (government concealment of information tolled statute of limitations), and *Belton* v. *Commissioner*, 562 F.Supp. 30 (D.D.C. 1982) (government misconduct in connection with tax lien levy that lulled third-party claimant not to timely file claim of entitlement as to levied funds estopped IRS from relying on otherwise applicable statute of limitations).

of Glendale, 15 Ariz.App. 402, 489 P.2d 65, 67 (1971); *Aetna Life Ins. Co.* v. *Wells*, 557 S.W.2d 144, 147 (Tex.Civ.App. 1977), writ of error refused, 566 S.W.2d 900, 901 (Tex. 1978) (per curiam).

2. While the United States has neither explained the genesis of the diplomatic correspondence nor conceded that U.S. officials were responsible for obtaining it, its appearance on the eve of the oral argument before the Federal Circuit cannot be coincidental. It strains credulity to believe that the Government of Panama, seven years after the Panama Canal Treaty was executed, was suddenly impelled, absent inducement by our State Department, unilaterally to express its views about a single provision of one Treaty Implementation Agreement. Also, while there is no evidence of a direct cause and effect relationship between the sudden appearance of the diplomatic correspondence and the "historic" $30 million foreign aid grant to Panama only some eight weeks earlier, the temporal proximity of the two events again hardly suggests a coincidence.

Such facts support the application of judicial estoppel against the United States. Application of this doctrine requires (1) an unqualified assertion of law or fact by a party in one judicial proceeding, and (2) an intentional contrary assertion by the same party in a subsequent judicial proceeding. *Bower* v. *O'Hara*, *supra*. Those elements are present here.

Before the Claims Court, the United States made the unqualified assertion that, as a matter of diplomatic practice it would not be "appropriate" to obtain a statement from the Government of Panama. The United States also maintained that it was not "necessary" to obtain such a statement. Indeed, the Government effectively conceded both before the Claims Court (Pet. App. 35a-36a) and before the Eleventh Circuit in *Harris* (Pet. App. 76a) that, as a matter of law, the Article XV(2) issues should be

decided without reference to *any* post-negotiation statements of any of the Panama Canal Treaty negotiators.

Before the Federal Circuit the United States took directly contrary positions—i.e. (a) that a statement from Panama was appropriately obtained, and (b) that the content of the statement, consisting of present day assertions of three individuals (two of whom were not even involved in the Article XV(2) negotiations), was proper matter to consider in interpreting Article XV(2). In other words, after telling the Claims Court that it was not "appropriate or necessary" to obtain any statement from Panama, it procured a statement from Panama for use before another Court.[16]

This is precisely the type of conduct that judicial estoppel is meant to prevent—the formulation of *ad hoc*, inconsistent litigation positions calculated to win at any cost and without regard to an accurate rendering of the facts and law. For that reason, the Federal Circuit should have judicially estopped the United States from introducing the diplomatic note.

3. Apart from its judicial dimension, the United States' conduct also taints the foreign policy process. The Government has used the tools of diplomacy not for any legitimate foreign policy purpose, but to bail itself out of a difficult, embarrassing and potentially costly domestic lawsuit.

4. A final consideration favoring the application of judicial estoppel was raised in the Claims Court opinion. In Federal tax refund suits prior to *Coplin*, *O'Connor*, and *Mattox*, the United States tendered an affidavit of Michael

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[16] Even in its opening brief below (at 46), the United States justified its refusal to ask Panama for its interpretation of Article XV(2) "because the Panamanian interpretation would be of little relevance even if it should prove to be contrary to the United States' position".

Kozak, now a deputy legal adviser at the State Department (Pet. App. 35a-36a, n. 16; App. 87-90). In 1977, Mr. Kozak was a member of the Department's Panama Canal Treaty negotiating team. The Kozak affidavit characterized the purpose of the negotiations surrounding Article XV(2) as limited to creating an exemption from Panamanian taxation. *Id.*

Below, the United States abandoned its reliance on the Kozak affidavit, admitting that Mr. Kozak was not present at the Article XV(2) negotiations. As the Claims Court noted:

> Defendant now concedes that the Kozak Affidavit may not be used to divine the purpose of Article XV. Feb. 23 Transcript at 30-32. Defendant has also suggested that reliance on the Kozak Affidavit to support its proposed finding as to intent was inadvertent. Reply Brief for the United States in Support of its Motion for Summary Judgment at 7 n. 4 (filed Jan. 23, 1984). Defendant has not, however, explained why paragraph 11 of the Kozak Affidavit was presented at all, given its position as to the admissibility of post-hoc statements by negotiators.

(Pet. App. 35a, n. 16). Having definitively committed itself to one position before the Claims Court on the admissibility of post-execution accounts of the Treaty negotiating process, the United States should not be permitted, on appeal, to again change its ground and adopt an entirely new position. Having conceded that the Kozak statement should not be considered in construing Article XV(2), the similar statements of Mr. Kozak's counterparts in Panama should also not be considered.[17]

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[17] The Claims Court was particularly disturbed by the fact that the Kozak affidavit had been submitted to Courts throughout the nation:

> Moreover, the Kozak Affidavit, in the very form presented to this

B. The Federal Circuit's Consideration Of Diplomatic Correspondence As New Evidence On Appeal Was Improper

Apart from the doctrine of judicial estoppel, the appellate level submission of the diplomatic correspondence was improper procedurally. Normally, material that is not part of the trial record cannot be considered on appeal. *Boone* v. *Chiles*, 35 U.S. 117 (1836). *Zell* v. *Jacoby-Bender, Inc.*, 542 F.2d 34 (7th Cir. 1976). The reasons for the prohibition are self-evident. Litigants are entitled to develop a trial record that includes all matters of fact and law that might be presented on appeal; trial courts should be given the first opportunity to rule on all contested matters of fact and law; and appellate Courts are ill-equipped to consider questions on which no record exists.

The Eleventh Circuit in *Harris*—based on the usual prohibition against introducing new evidence on appeal—refused to consider the same diplomatic correspondence tendered to and received by the Federal Circuit. The *Harris* court rejected the correspondence not because the court lacked power to judicially notice it, but because the correspondence required "additional explanation" (Pet. App. 76a). As we show below, that ruling was proper as a

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court, has been presented to other courts that have considered this issue. See n. 9 supra. Some of those courts have expressly relied on it. See, e.g., *Stabler* v. *United States*, No. CA3-83-0166-R, slip op. at 3 (N.D.Tex. Nov. 30, 1983); *Pierpoint* v. *United States*, No. 83-0354-2, slip op. at 5-6 (D.S.C. Oct. 3, 1983). Other courts may have been swayed by the affidavit without specifically mentioning it.

(Pet. App. 35a-36a, n. 16). As the Claims Court also noted (*id.*), this conduct resulted in substantial costs to the American public and the judicial system in litigating the Article XV(2) question:

> At least 42 lawsuits, involving perhaps hundreds of plaintiffs, have presented the issue to this and other courts. See n. 9 supra. The cost borne by the plaintiffs, the defendant and the judicial system in resolving this issue through piecemeal litigation has been, and will continue to be, substantial.

matter of law. The Federal Circuit's contrary ruling was error.

1. In a dispute over treaty interpretation, many aspects of the treaty's genesis and subsequent development may be considered. Section 147 of the Restatement of Foreign Relations Law (1965) lists nine permissible criteria for treaty interpretation including: the plain meaning of the agreement, the historical context of the agreement, the drafts and other documents submitted for consideration, the record of negotiations, the language of the treaty in any translation, and a comparison of the translations. Significantly, the Restatement does not include post-treaty diplomatic correspondence as an acceptable criteria.[18]

2. But assuming *arguendo* that post-treaty diplomatic correspondence is relevant, the Federal Circuit's judicial notice and consideration of the correspondence as conclusive of the Treaty interpretation issue was reversible error. To the extent it may be considered at all, the correspondence should not have been considered without affording the petitioners their rights to test and contest it on an adversary record. Such an opportunity is required, for example, by Rule 201(e) of the Federal Rules of Evidence, which provides that the opponent of evidence proposed to be noticed judicially must be heard on both the content of the evidence and the manner of its introduction.[19]

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[18] Article 31 of the Vienna Convention on the Law of Treaties (63 AJIL 875 (1969)) would appear to accept such post treaty correspondence as secondary criteria. The U.S. is not a party to the Vienna Convention.

[19] To the same effect is Rule 44.1 of the Claims Court rules (identical to the similarly numbered Federal Rule of Civil Procedure), which requires a party intending to raise an issue of foreign law to provide opponents with reasonable written notice of the issue. Rule 44.1 of the Federal Rules of Civil Procedure has been held to require prior notice of evidence relating to a foreign nation's interpretation of a bilateral treaty. See *United States* v. *VETCO*, 691 F.2d 1281 (9th Cir. 1981).

Before the Federal Circuit, the United States successfully urged that the correspondence be considered notwithstanding "the *arbitrary* rules that might normally govern discovery in a trial court or preclude an appellate court from reviewing information not considered by the lower court" (emphasis added). Opposition of the United States to Appellee's Motions to Strike, at 3, March 5, 1985. The Justice Department may characterize American civil procedure as it wishes, but the fact remains that those "arbitrary" rules embody the basic tenets of due process and fundamental fairness.

3. If those "arbitrary" rules had been applied, the Federal Circuit would have been required to consider the following points which were made in Petitioners' Motions to Strike (filed on March 4, 1985, prior to oral argument) and Petitioners' Petitions for Rehearing (filed on May 24, 1985, following the Federal Circuit's decision):

- In the transcript of a July 1984 meeting of the Commission's supervisory board, Dr. Fernando Cardoze—the author of the disputed diplomatic transmittal note—expressed the view that the U.S. citizen employees of the Commission should not receive any added compensation (by way of a cost-of-living-allowance) because they already were entitled to the substantial benefit of exemption from U.S. income tax;

- Two of the three letters that accompanied the Cardoze transmittal were written by individuals who were not present at the negotiating sessions that involved the

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As discussed above, the United States expressly declined the Claims Court invitation to procure such evidence. See also *Jannenga* v. *Nationwide Life Insurance Co.*, 288 F.2d 169 (D.C.Cir. 1961) (per Burger, J.) (party that sought the application of District of Columbia case law at trial prevented from arguing on appeal that trial court should have judicially noticed the law of Ohio or Missouri).

taxation of U.S. employees. Moreover, there is no evidence that any of the three was present at the session when Article XV(2) was accepted by Panama;

- Although Foreign Minister Cardoze says he consulted Dr. Aristides Royo (a negotiator for the Government of Panama, who was present at all the negotiating sessions), no letter from Dr. Royo was sent to the American Embassy with the other three;

- No inquiry was made of Dr. Carlos A. Lopez-Guevara, Panama's Ambassador Extraordinary and Plenipotentiary to the Treaty negotiations, whose affidavit had been of record in this litigation since March 8, 1984.

4. Nor was the Federal Circuit correct in equating the late introduction of the diplomatic correspondence below with the introduction, in *Sumitomo Shoji America, Inc.* v. *Avagliano*, 457 U.S. 176, 184, n. 9 (1982), of a diplomatic note from the Ministry of Foreign Affairs of Japan. The *Sumitomo* note was submitted on February 26, 1982, two months in advance of oral argument. (The Federal Circuit incorrectly characterized the filing of the *Sumitomo* note as occurring "within a few days of argument before the Court".)

As the *amicus curiae* brief of the United States in *Sumitomo* observed, the February 26, 1982 diplomatic cable from the Ministry of Foreign Affairs of Japan (MFA) was not submitted to establish a new interpretation of the disputed Treaty. That cable was simply a reaffirmation of the Ministry's previous view. See Appendix B to Brief for the United States as *amicus curiae* in the *Sumitomo* case.

The cable was submitted for the limited purpose of resolving an intra-mural squabble that surfaced during *Sumitomo* between the MFA and the Japanese Ministry of International Trade and Industry (MITI). The cable clarified that MFA and not MITI was the instrumentality within

the Government of Japan whose view should be deemed the official view:

> *Sumitomo* refers (Br. 20) to the brief *amicus curiae* filed by the Ministry of International Trade and Industry (MITI) of the Government of Japan in this case. The MITI brief does not specifically address the legal question of whether *Sumitomo* is a company of Japan for purposes of the Treaty. But because MITI's brief might be understood to support *Sumitomo*'s position on this issue, and in order to assist the Court by resolving any resulting confusion regarding the position of the Government of Japan on this issue we requested the State Department to seek clarification from MFA. The February 26, 1982 statement of MFA, reiterating its previous view (App. B, infra) is the result of that inquiry.

Brief for the United States as Amicus Curiae, *supra*, as reported on LEXIS at 14. *Sumitomo* cannot be read, as it was by the Federal Circuit, for the much broader proposition that a foreign government may, by diplomatic correspondence tendered to a U.S. court at any stage of its proceedings, create a retroactive interpretation of an extant treaty. As this Court ruled in *Sumitomo*, it is not proper to read a government's current view of a treaty as evidence of its original intent in entering into the treaty. *Sumitomo*, *supra*, at n. 10.

Moreover, the form of the diplomatic correspondence submitted below, i.e., 3 post-treaty statements by Panamanian negotiators, accompanied by a transmittal letter from Panama's then Foreign Minister, is dubious authority. As the Claims Court observed below (Pet. App. 36a, n. 16), it is far from clear whether a negotiator's post-treaty accounts of negotiating sessions are admissible to create, as the Federal Circuit did here, a retroactive interpretation. The O'Connors submit that such accounts should be subject to the bar against noncontemporaneous testimony

by legislators about legislative intent in enacting statutes. *City of Los Angeles* v. *Superior Court,County of Los Angeles*, 170 Cal. App. 3d 744, 216, Cal. Rptr. 311 (1985).

Nor should the Court overlook the fact that the United States was *amicus curiae* in *Sumitomo* and therefore a disinterested intermediary. Here, the United States' conduct must be viewed with a jaundiced eye, as it is not only a litigant, but it has a substantial financial interest in the outcome. Its conduct, therefore, must be subject to the customary restraints against the untimely introduction of "new evidence". See, for example, *Labadie Coal Co.* v. *Black*, 672 F.2d 92 (D.C. Cir. 1982). Such evidence should be subject to the healthy skepticism attaching to material tendered at the last moment and having no prior independent existence.

II. Article XV(2) Exempts U.S. Citizen Employees Of The Panama Canal Commission From U.S. Income Taxation On Their Commission Salaries

A. The Meaning Of Article XV(2) Is Clear And Should Be Given Effect

Treaties are contracts between nations. Like other contracts they are interpreted according to the rule that the plain meaning of a legal instrument is controlling, absent extraordinary reasons. *Sumitomo Shoji America, Inc.* v. *Avagliano*, 453 U.S. 176, 181 (1982); *Maximov* v. *United States*, 373 U.S. 49, 54 (1963); *Choctaw Nation of Indians* v. *United States*, 318 U.S. 423, 432 (1943); *Valentine* v. *United States*, 299 U.S. 5, 11 (1936); *Santovincenzo* v. *Egan*, 284 U.S. 30, 40 (1931); *United States* v. *Texas*, 162 U.S. 1, 36 (1896).

It is difficult to conceive of language with clearer meaning than Article XV(2). The category of persons to which it applies is expressly stated, and the nature of the exemption to which they are entitled is precisely delineated. Nowhere in the Treaty package is there treatment of the

same subject matter, nor is there other language that creates an ambiguity, or the latent possibility of one. The decision of the Claims Court was correct on these grounds alone. "Any taxes" means *any* taxes. The Claims Court below and the Eleventh Circuit in *Harris* were correct in so holding.

B. The Omission From Article XV(2) Of Limiting Language That Was Used Elsewhere In The Treaty And Agreement Requires That The Plain Meaning Be Given Effect

As noted by the Claims Court, the common-sense interpretation of the phrase "any taxes" in accordance with its plain meaning finds authoritative support in other provisions of the Treaty package. For example, the first paragraph of Article XV, which applies to the Commission, its contractors and subcontractors (but not the Commission's employees), provides that they "are exempt from payment *in the Republic of Panama* of all taxes . . . on their activities or property" (emphasis added).

In the case of paragraph three of Article XV, which deals with personal property, gift and inheritance taxes of U.S. citizen employees, the exemption also is limited by specific language. It provides that the mere presence of personal property of American employees "within the territory of the Republic of Panama . . . due solely" to their work for the Commission will not give rise to the host country's usual exercise of *in situ* tax jurisdiction.

The Treaty itself, in Article IX(9), provides another illustration of how the parties used specific terms to limit the application of the rule or restriction upon which they had agreed. Paragraph 9 pertains to vessels, cargo, passengers and crew that transit the Canal. It says that they "shall be exempt from any taxes, fees, or other charges *by the Republic of Panama*" (emphasis added). The provision goes on to say—demonstrating the particularity with which the negotiators treated taxation—that:

> The Republic of Panama may also require the passengers and crew disembarking from such vessels to pay such taxes, fees and charges as are established *under Panamanian law* for persons entering its territory (emphasis added).

Similarly, in paragraph 2(e) of Article XI of the Implementation Agreement, the income of the Commission's U.S. contractors (as distinguished from their activities and property, which are covered by Article XV(1)) is expressly made subject to Panama taxation unless it is taxed by the United States at a substantially equivalent rate. This section strongly suggests that the U.S. treaty negotiators were capable of being equally as precise if they had intended to retain for the United States the right to tax Americans on their Commission salaries.[20]

The Government has argued below that the repeated use of these explicit limitations in other parts of the Treaty agreements should permit the court to engraft similar language onto Article XV(2). The Claims Court correctly concluded, however, that such a radical departure from the plain meaning of Article XV(2) was unwarranted under applicable rules of treaty construction (Pet. App. 26a).[21]

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[20] The trial court discussed other provisions in the treaty documents where specific language was employed to create unilateral limitations (Pet. App. 23a-27a).

[21] When the Treaty was transmitted to the Senate by the Executive Branch (S. Exec. Rep. 95-12, 95th Cong., 2d Sess. 155 (1978)), it was accompanied by a section-by section analysis which stated that the provision here in dispute was intended to provide an exemption only from Panamanian taxes. In the courts below, the Government relied on that section-by-section analysis implying that it constituted contemporaneous legislative history as to the meaning of the provision. In fact, like the Kozak affidavit, the analysis was prepared after the Treaty. In addition, the Government conceded before the Claims Court that the analysis was prepared by State Department officers, Kozak and Geraldeen Chester, "who were not present at any of the negotiating

C. The Use By The United States Of Specific Limitations In Other International Agreements Demonstrates That This Was A Deliberate Omission

The Government suggested below the possibility of a drafting error. The Government argued that, although the U.S. negotiators were skilled, "even skilled persons do not always use the most precise language" (U.S. Government Brief to the Federal Circuit, filed November 30, 1984, p. 42). If it is the Government's explanation that this litigation stems from a drafting error, taxpayers submit that such a proposition is untenable. The record shows that ranking officials in the State and Treasury Departments participated in the preparation and negotiation of the U.S position. The Court may take notice that Ambassadors Ellsworth Bunker and Sol Linowitz, who conducted and concluded the negotiations with Panama, were experienced officers in the diplomatic service.

The truth of the matter is that the language of Article XV(2) is both special and unique. The Kozak affidavit (App. 87-90) says that it had its genesis in the standard Status of Forces Agreements (SOFA) reached by the United States with other countries. If that is so, then the substantive changes in wording from prior usage—which undeniably have changed the meaning—cannot reasonably be said to have been unintentional or inadvertent. This is seen by examining the corresponding provisions in various SOFA Agreements, while noting that the O'Connors know of no SOFA Agreement that is similar to Article XV(2). In the SOFA negotiated among the parties to the North

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sessions during which we know that the substance of Article XV was discussed" (Pet. App. 57a). Finally, the Claims Court properly observed that the issue was presented to the Senate by the Executive Branch without disclosure of any of the negotiating history showing that there was a serious binational question involved (Pet. App. 59a). Before the Senate, therefore, the issue appeared as one merely of domestic tax law which, as then Legal Advisor Hansell said, would be handled as "an internal matter" (U.S. App. 12a).

Atlantic Treaty (signed June 19, 1951 and entered into force August 23, 1953), the pertinent language of Article XI(1) states:

> Members of a force or civilian component shall be exempt from taxation *in the receiving State* on the salary and emoluments paid to them as such members *by the sending State* or on any tangible movable property the presence of which *in the receiving State* is due solely to their temporary presence there (emphasis added).

The supplementary agreement to the NATO Status of Forces Agreement pertaining to forces stationed in the Federal Republic of Germany was signed by seven countries on August 3, 1959 and entered into force July 1, 1963. In Part II of the agreement pertaining to Article 68, the following "agreed declaration" concerning German taxes appears at paragraph 2(a):

> Tax is imposed only on internal income, i.e., in general, income earned *within the Federal Republic*, except emoluments and income paid to members of a force or of a civilian component *by the sending State* in their capacity as such members (emphasis added).

A similar provision limiting the tax exemption of U.S. armed force members and the civilian component is contained in the 1960 Agreement Under Article VI of the Treaty of Mutual Cooperation and Security between Japan and the United States. Article XIII(2) of that Agreement provides:

> Members of the United States armed forces, the civilian component, and their dependents shall not be liable to pay *any Japanese taxes to the Government of Japan* or to any other taxing agency in Japan on income received as a result of their services with or

> employment by the United States armed forces (emphasis added).

The SOFA between Australia and the United States, in like manner, provides in Article 6(1), that:

> Income derived by a member of the United States Forces or of the civilian component from rendering services as a member to the United States Government in Australia, *shall be deemed not to have been derived in Australia*, provided it is not exempt, and is brought to tax, under the taxation laws of the United States (emphasis added).

Agreement Concerning the Status of United States Forces in Australia, signed May 9, 1963 and entered into force May 9, 1963. Article XIV(2) under Article IX of the Mutual Defense Treaty between the United States and the Republic of Korea (signed July 9, 1966 and entered into force February 9, 1967) similarly states:

> Members of the United States armed forces, the civilian components, and their dependents shall not be liable *to pay any Korean taxes to the Government of the Republic of Korea or to any other taxing agency in the Republic of Korea* on income received as a result of their service with or employment by the United States armed forces, including the organizations provided for in Article XIII (emphasis added).

Further illustrating the fact that Article XV(2) was a special departure from established U.S. Government policy is the Convention Between the United States and Egypt, signed August 24, 1980 (T.I.A.S. 10149). That agreement, executed three years *after* Article XV(2), continues the pattern of the pre-Panama Canal treaty tax provisions discussed above. Article 21(1) of that Agreement states:

> Wages, salaries, or similar remuneration, including pensions, annuities, or similar benefits paid from public funds of one of the Contracting States:

(a) To a citizen of that Contracting State, or
(b) To a citizen of a State other than a Contracting State who comes to the other Contracting State expressly for the purpose of being employed by the first-mentioned Contracting State

for labor or personal services performed as an employee of the national Government of that Contracting State, or any agency thereof, in the discharge of functions of a governmental nature *shall be exempt from tax by the other Contracting State* (emphasis added).

Given this depth of U.S. Government experience in drafting tax provisions in treaties, it may properly be concluded that the U.S. negotiating team simply could not have been so lacking in knowledge as to have adopted Article XV(2) without intending to create a binational exemption. As stated so aptly in *Santovincenzo* v. *Egan*, 284 U.S. at 37 "[t]he omission from Article VI of the Treaty with Persia of a clause of this sort, so frequently found in treaties of this class, must be regarded as deliberate".

D. The Federal Circuit Erred In Refusing To Consider Other Official Statements By Panama That Support The Construction Of Article XV(2) As A Binational Exemption

The admissibility of the diplomatic correspondence from Panama is treated in Point I of this brief. Even if *arguendo* the correspondence might be admissible from a procedural standpoint, it was improper for the Federal Circuit to consider that material alone. The papers consisted of almost identical letters from three former Panamanian negotiators. These letters were delivered, in February 1985, to the U.S. Embassy in Panama with a brief transmittal note from then Foreign Minister, Dr. Fernando Cardoze (U.S. App. 4a-9a). The thrust of the note and the letters is that the Ministry's position at that time coincided with that of the State Department.

On March 4, 1985, the O'Connors filed a motion to strike the correspondence. Attached to their motion was a transcript of certain remarks made in July 1984 by the then Foreign Minister of Panama (Mr. Oyden Ortega) and by Dr. Fernando Cardoze (the person later to succeed Mr. Ortega and who, as Foreign Minister, signed the note that transmitted the three letters). The transcript was from the official record of a meeting of the Commission's nine-member supervisory board (*supra*, pp.18, 30) established under Article III(3a) of the Canal Treaty and Pub.L. 96-70, §1102, Sept. 27, 1979, 93 Stat. 456, 22 U.S.C. §3612.

The question under discussion was whether U.S. citizen employees should be given a cost of living allowance (COLA) to compensate them for the impending loss of their postal, commissary and post exchange privileges to take place in October 1984 pursuant to Article XIII(3) of the Implementation Agreement. Under §1206 of Pub.L. 96-70, the Commission had permissive authority to grant such a COLA. The four Panamanian members of the board were adamantly opposed to extending such a benefit, principally because it would create a disparity in treatment between U.S. and Panamanian employees. Dr. Cardoze expressed the view that the exemption from U.S. income taxation created by the Treaty was the form of "special compensation" that the U.S. citizen employees should receive:

> I think the U.S. negotiators were wise, and just as the Panamanian negotiators extablished that the privileges would be eliminated—why did they do that? Because they knew that would be an irritant in the relationship. Likewise, the American negotiators were very wise. They looked for a manner in which they could give a compensation to the U.S. employees, in fact much more than the COLA could give. There is a clause that says the U.S. citizen will not pay taxes for the salaries that they earn from the Panama Canal Commission.

> So if you believe that it is necessary to grant an additional compensation, then let's not make a mistake. Let us give them—let's give this additional compensation to all employees, or if you want to give a special compensation to the U.S. citizens who were here prior to October 1, 1979, and who are going to lose their privileges, then let us look for it in the U.S. treasury, and probably in the Treaty is already a basis for such a benefit.

At the board's session on the following day, Minister Ortega commented as follows:

> MINISTER ORTEGA: (Through the interpretor) It happens, Mr. Chairman, that in my interventions previously, Dr. Cardoze had expressed the aspect related to the income tax matter that could be something that—could be an exemption for the U.S. citizen, and that undoubtedly this would be a form of—it would be a real economic compensation.

At these board meetings, Minister Ortega and Dr. Cardoze both were participating officially on behalf of their Government in the management of the Panama Canal as contemplated by Article III of the Treaty. They were also speaking on a matter directly related to the interpretation of Article XV(2).[22] Their statements, clearly within the rule set out in *United States* v. *Reynes*, 50 U.S. (9 How.) 127, 147-48 (1850), should have been accepted by the Federal Circuit as more persuasive evidence of Panama's position than any other submission in the case.

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[22] These meetings were under the Chairmanship of U.S. Assistant Secretary of the Army William R. Gianelli. Only some two months earlier (on May 4, 1984), Secretary Gianelli had written a three page official letter to Assistant Secretary of State Langhorne A. Motley urging that the Executive Branch agree that Article XV(2) did in fact create a binational tax exemption. Secretary Gianelli's letter was attached as Appendix 6 to the O'Connor brief in the court below.

Such a conclusion becomes even more compelling upon careful analysis of the three letters. In the case of Mr. Jaime Arias (U.S. App. 9a), he claimed to have had a role only in the negotiation of Article XVI(2) (which is in the SOFA that implements Article IV of the Treaty), implicitly admitting that he was not involved with Article XV(2). As for Drs. Ahumada and Escobar, they stated that Articles XV(2) and XVI(2) in question "were discussed, negotiated, and drafted exclusively with respect to the tax exemptions that . . . Panama would grant." Unlike Dr. Lopez-Guervara, however, neither individual states that he participated in the negotiations where these articles were adopted. Indeed, the record contains no evidence that Dr. Ahumada ever participated in any of the meetings on the question of taxation.

If the Court should conclude that the tendered diplomatic correspondence is admissible at all, the O'Connors urge that, in any event, it should be considered side-by-side with the diametrically inconsistent opinions expressed by Minister Ortega and Dr. Cardoze only seven months before.[23]

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[23] The interpretation of Article XV(2) as a binational tax exemption is further supported by the statute that was passed to implement the Treaty package. Prior to the Treaty's entry into effect on Oct. 1, 1979, a *tax allowance* was paid U.S. citizen employees of the Canal agency pursuant to 2 C.Z.Code §146(1), 76A Stat. 17. The authority for payment of that allowance was repealed by the Treaty-implementing legislation, §3303(a)(1) of Pub.L. 96-70, 93 Stat. 499, 22 U.S.C. §3602, Sept. 27, 1979. The Commission, in turn, published regulations on Oct. 2, 1979, to deny the tax allowance to newly-hired U.S. citizens. 44 Fed.Reg. 56693. Subsequently, the Commission eliminated the allowance with respect to *all* U.S. citizen employees. 45 Fed.Reg. 59150, Sept. 8, 1980. See 35 CFR 134(b), Dec. 1979 ed.

Repeal of the tax allowance, which became superfluous in view of the tax exemption, constituted a *practical construction* of Article XV(2) by Congress consistent with the interpretation of Article XV(2) as a binational tax exemption. In an appropriate case, subsequent legislative action may demonstrate what intent underlies the initial enactment.

E. The Cases Relied On By The Government Are Inapposite

The appellate court below based its decision almost entirely upon the three letters that the State Department received from then Panama Foreign Minister Cardoze and transmitted to the Court of Appeals one working day before the oral argument. In doing so, the Court failed to acknowledge that the words "any taxes" as used in Article XV(2) can reasonably be interpreted in only one way. The Court concluded simply that its role was "limited to giving effect to the intent of the Treaty parties" (Pet. App. 6a) as disclosed in the three letters. By doing so, the Court ignored the applicability of the plain meaning rule and, with nothing more than a single sentence of its opinion, dismissed the extended, careful discussion by the Claims Court of the plain meaning rule as it affects this treaty dispute.

In a concurring opinion, three of the five-member panel below expressed the view that the letters were not essential to their decision in favor of the Government. Their conclusion also ignored the text and plain meaning of Article XV(2). Rather than construing the language, they judicially engrafted on the title of the article (i.e., "Taxation") the words "by the Republic of Panama" (Pet. App. 8a).

In the proceedings below, the Government repeatedly asserted that the plain meaning of the Implementation Agreement need not be followed if the result would be contrary to the intent of the signatories. In support of that contention, the Government cited this Court's decisions in the following cases: *Sumitomo Shoji America, Inc.*

"We regard the action of the Congress, following that of the State, as a practical construction of the treaty. . . ." *Pigeon River Improvement, Slide & Boom Co.* v. *Charles W.Cox, Ltd.*, 291 U.S. 138, 160-61 (1934).

v. *Avagliano*, 457 U.S. 176 (1982); *Maximov* v. *United States*, 373 U.S. 49 (1963); *United States* v. *Texas*, 162 U.S. 1 (1896); and *Ross* v. *McIntyre*, 140 U.S. 453 (1891).

Examination of these decisions reveals that in none of them does the actual holding stand for the proposition espoused by the Government. The Government relies principally on *Sumitomo* and places special emphasis (as did the Federal Circuit) on the portion of the opinion which reads: "Our role is limited to giving effect to the intent of the Treaty parties." 457 U.S. at 186. Both the Government and the Federal Circuit, however, overlook the subsequent statement that delineates what the Court actually held:

> When the parties to a treaty both agree as to the meaning of a treaty provision, *and that interpretation follows from the clear treaty language*, we must, absent extraordinarily strong contrary evidence, defer to that interpretation (emphasis added).

In *Sumitomo*, which involved only private litigants, the Government appeared as *amicus curiae*, as noted above (*supra* at 31-33), and presented a cable from Japan which reaffirmed that country's earlier opinion. The opinion agreed upon by the U.S. and Japan accorded with the plain meaning of the clause in question, and the Court held that it should be so construed. There is a crucial difference between that situation and the case at bar. Here the Government asserts that Article XV(2) *does not mean what it says* and that Panama now shares the same view. The result and reasoning of *Sumitomo* do not support the Government's theory that the plain and obvious meaning of the words "any taxes" may be altered merely because the two governments are said to have arrived at that conclusion in February 1985, seven years after the article was agreed upon.

Examination of the three other decisions also reveals that none of them supports the Government's position. In

Maximov, this Court considered a tax treaty which exempted residents of the United Kingdom from U.S. capital gains taxation. It held that the plain meaning of the term "resident of the U.K." should be given effect and a tax exemption was denied to the claimant trust that was a resident of the U.S., although with U.K. beneficiaries. The opinion by way of dicta said:

> . . . it is particularly inappropriate for a court to sanction a deviation from the clear import of a solemn treaty between this Nation and a foreign sovereign, when, as here, there is no indication that application of the words of the treaty according to their obvious meaning effects a result inconsistent with the intent or expectations of its signatories. 373 U.S. at 54.

In *United States* v. *Texas*, as noted above, the Court stated that the intention of the two governments, gathered from the words of the treaty, must control. The decision shows, however, that there were complex questions raised by the nonconformity of the treaty text with a map to which it made reference. Those ambiguities meant that there was *no plain meaning* that could be given effect—making it necessary for the Court to construe the disputed language by referring to objective geographic data.

Ross v. *McIntyre* required the interpretation of two treaties between the U.S. and Japan, entered into in 1857 and 1858, to determine whether the American Consul General had jurisdiction to try a U.S. citizen for a crime committed in Japan. It was necessary to resolve an ambiguity raised by the second treaty. Application of plain meaning, such as is presented in the present case, was not at issue.

None of the cases relied upon by the Government below supports the alteration of language sense where, as here, there is no ambiguity and the subject matter does not appear elsewhere in the treaty documents. This is an instance, it is submitted, where no applicable precedent or principle permits the treaty terms to be narrowed. "As

treaties are contracts between independent nations, their words are to be taken in their ordinary meaning 'as understood in the public law of nations.' " *Santovincenzo* v. *Egan*, 284 U.S. at 40. The O'Connors urge the Court to apply here the elementary canon of construction that it used in interpreting a provision of the Civil Rights Act of 1964, when it said:

> [T]he plain, obvious and rational meaning of a statute is always to be preferred to any curious, narrow, hidden sense that nothing but the exigency of a hard case and the ingenuity and study of an acute and powerful intellect would discover.

Chandler v. *Roudebush*, 425 U.S. 840, 849 (1976).

F. The History And Tenor Of The Treaty Negotiations Confirm That Article XV(2) Is A Binational Tax Exemption

As indicated above, Panama was adamantly opposed to the notion that it should be barred from taxing United States citizens who lived and worked in Panama as PCC employees. As late as July 14, 1977, Panama insisted that such employees, who would enjoy all the governmental services of the new sovereign, must pay their fair share of taxes to Panama.

In all previous Article XV(2) litigation, the United States maintained that, notwithstanding the exemption from "any taxes" contained in Article XV(2), the negotiations ended in mid-August 1977 with Panama acceding to the U.S. demand that the PCC income of U.S. citizen employees be off-limits to Panamanian taxation. As shown below, however, such a result is inconsistent with the course and tenor of the Treaty negotiations, and the long, stormy history of Panama-U.S. relations. The negotiating history clearly suggests that Article XV(2)'s object was to establish a binational tax exemption as a compromise between the sharply divergent Panamanian and American positions.

1. The precise language of Article XV(2) was adopted from a parallel provision of Article XVI(2) of the Implementation Agreement of Article IV of the Treaty, governing the status of U.S. Forces in Panama. The language of the Article IV Implementation Agreement is almost identical to the language of Article XV(2) except that, in the second sentence, an explicit reference is made to taxation "as is provided by Panamanian law":

> Members of the Forces or the civilian component, and dependents, shall be exempt from any taxes, fees, or other charges on income received as a result of their work for the United States Forces or for any of the service facilities referred to in Articles XI or XVIII of this Agreement. Similarly, *as is provided by Panamanian law* they shall be exempt from payment of taxes, fees, or other charges on income derived from sources outside of the Republic of Panama (emphasis added).

An earlier draft of the Article XV(2) language, dated June 26, 1977, contained the identical second sentence reference to taxation "as is provided by Panamanian law".

The final text (supra, pp.3,36) shows that the language ultimately agreed to by Panama and the United States in Article XV(2) was purged of all reference to "Panamanian law".

Given the absence of a negotiating record for the sessions at which Article XV(2) was adopted, it may never be definitively ascertained why the terminology "as provided by Panamanian law" was dropped from Article XV(2) but retained in the parallel Implementation Agreement for Article IV of the Treaty. The circumstances suggest, however, that the elimination from Article XV(2) of the only language referring to *either* Treaty party was intended to leave absolutely no question but that the Article XV(2) exemption was applicable to *both* Treaty parties.

2. Interpretation of Article XV(2) as a compromise formulation, exempting the U.S. citizen PCC employees from taxation by *both* Treaty parties, is fully consistent with the political agenda of each of the negotiating parties. From the Panamanian point of view, mutual acceptance of a binational tax exemption would confer special recognition on the binational status of the Panama Canal Commission, which Panama viewed as a partnership of equals. It would also erase any lingering doubt that the U.S. intended to assert, by the taxation power, continuing "colonial" authority over the Canal area.

From the perspective of the United States, a binational exemption would avoid the undesirable precedent of Panamanian taxation of the income of Americans employed by the Panama Canal Commission. It also would avoid the danger (noted by Ambassadors Bunker and Linowitz) that giving Panama the right to tax these U.S. employees might be used by treaty opponents to oppose ratification.

3. For both nations, a binational tax exemption was a relatively inexpensive solution to the impasse. Panama, of course, had never taxed income earned by U.S. citzen employees of the former "Canal Zone". Accordingly, Panama lost nothing by negotiating away the power to tax them. And, as discussed above, such salaries, historically, have been either free of U.S. tax prior to 1951 or taxed at a lower effective rate thereafter. Moreover, the fiscal impact on the U.S. was even further diminished because the pool of U.S. citizen-employees potentially benefiting from the exemption would, by operation of the Treaty, progressively diminish and, by the year 2000, disappear. Also, the U.S. negotiators, in general, viewed the taxation dispute as a political problem largely bereft of any real economic significance.[24]

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[24] In contrast to these tenable explanations for the compromise, the Government in its Reply Brief in *Harris* (at p. 7, n.4), was unable to offer any explanation of why Panama allegedly capitulated, stating that:

4. Finally, a tax exemption for U.S. citizen PCC employees was a modest cost compared with the other economic concessions made by the United States to Panama in the Treaty package. In all, the United States obligated itself: to pay Panama an annuity which would increase from $50 or 60 million annually to $80 or 90 million annually when the treaty terminates in 1999; to secure approximately $300 million in aid credits for Panama; and to turn over to Panama property previously owned by the U.S. Government having an estimated replacement value of $8 billion. *See* S. Exec. Rep. 95-12, 95th Cong., 2d Sess. (1978) at 91 *et seq.* The modest tax exemption conferred by Article XV(2) is entirely consistent with the pattern of other economic concessions provided for in the Treaty package.

CONCLUSION

For the foregoing reasons, the decision of the United States Court of Appeals for the Federal Circuit should be reversed.

ALLAN I. MENDELSOHN
MARVIN L. SZYMKOWICZ
WARD & MENDELSOHN, P.C.
1100 17th Street, N.W.
Suite 900
Washington, D.C. 20036
(202) 785-0200
Counsel for Petitioners

Of Counsel
DWIGHT A. MCKABNEY
Apartado 3116
Balboa-Ancon
Republic of Panama
011-507-63-5316

"Exactly why the Panamanians accepted the U.S. position may never be known with certainty".

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In the Supreme Court of the United States

OCTOBER TERM, 1985

ROBERT E. O'CONNOR AND GLADYS E. O'CONNOR, PETITIONERS

v.

UNITED STATES OF AMERICA

PAUL H. COPLIN AND PATRICIA COPLIN, PETITIONERS

v.

UNITED STATES OF AMERICA

JACK R. MATTOX AND MARIA MATTOX, PETITIONERS

v.

UNITED STATES OF AMERICA

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

BRIEF FOR THE UNITED STATES

CHARLES FRIED
Solicitor General

ROGER M. OLSEN
Assistant Attorney General

LAWRENCE G. WALLACE
Deputy Solicitor General

JERROLD J. GANZFRIED
Assistant to the Solicitor General

MICHAEL L. PAUP
DAVID ENGLISH CARMACK
Attorneys

Department of Justice
Washington, D.C. 20530
(202) 633-2217

ABRAHAM D. SOFAER
Legal Adviser
Department of State
Washington, D.C. 20520

QUESTION PRESENTED

Whether the court below correctly determined that Article XV of the Agreement in Implementation of Article III of the Panama Canal Treaty, Sept. 7, 1977, United States-Panama, T.I.A.S. No. 10031, did not exempt the petitioners from United States taxation on the salaries that they received from the Panama Canal Commission.

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In the Supreme Court of the United States

OCTOBER TERM, 1985

No. 85-558

ROBERT E. O'CONNOR AND GLADYS E. O'CONNOR, PETITIONERS

v.

UNITED STATES OF AMERICA

No. 85-559

PAUL H. COPLIN AND PATRICIA COPLIN, PETITIONERS

v.

UNITED STATES OF AMERICA

No. 85-560

JACK R. MATTOX AND MARIA MATTOX, PETITIONERS

v.

UNITED STATES OF AMERICA

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

BRIEF FOR THE UNITED STATES

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-8a) is reported at 761 F.2d 688. The opinion of the United States Claims Court (Pet. App. 9a-69a) is reported at 6 Cl. Ct. 115.

JURISDICTION

The judgments of the court of appeals were entered on May 10, 1985, and petitions for rehearing were denied on July 3, 1985 (Pet. App. 70a-71a). The petitions for a writ of certiorari were filed on September 30, 1985, and were granted on January 13, 1986. The jurisdiction of this Court rests on 28 U.S.C. 1254(1).

TREATY AND EXECUTIVE AGREEMENT INVOLVED

Article III, paragraph 9, of the Panama Canal Treaty, Sept. 7, 1977, United States-Panama, T.I.A.S. No. 10030, and Article XV of the Agreement in Implementation of Article III of the Panama Canal Treaty, T.I.A.S. No. 10031, are set forth at U.S. App. 1a-2a.[1]

STATEMENT

1. On September 7, 1977, the United States and the Republic of Panama signed the Panama Canal Treaty, which was approved by the Senate and entered into force on October 1, 1979. That Treaty restored to Panama territorial sovereignty over the

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[1] "U.S. App." refers to the appendix to the government's brief filed in this Court on December 3, 1985, in response to the petitions. "O'Connor Br." refers to the petitioners' brief in No. 85-558. "Coplin Br." refers to the petitioners' brief in No. 85-559. "Mattox Br." refers to the petitioners' brief in No. 85-560.

Canal Zone, while granting to the United States the right to manage, operate and maintain the canal until the year 2000 under the auspices of the Panama Canal Commission (Commission), an agency of the United States government (Pet. App. 3a).[2] Among the many questions addressed during the treaty negotiation was whether United States citizens employed by the Commission would be subject to Panamanian income taxes on their wages. The parties to the Treaty resolved that question by agreeing that such earnings would not be taxed by Panama. That determination is reflected in Article XV of the Agreement in Implementation of Article III of the Panama Canal Treaty, also signed on September 7, 1977, which provides in pertinent part as follows:

TAXATION

> 1. By virtue of this Agreement, the Commission, its contractors and subcontractors, are exempt from payment in the Republic of Panama of all taxes, fees or other charges on their activities or property.
>
> 2. United States citizen employees and dependents shall be exempt from any taxes, fees, or other charges on income received as a result of their work for the Commission. Similarly, they shall be exempt from payment of taxes, fees or other charges on income derived from sources outside the Republic of Panama.
>
> 3. United States citizen employees and dependents shall be exempt from taxes, fees or

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[2] The Commission is defined as a United States government agency in Article III(3) of the Treaty and in Article I(1) of the Agreement in Implementation of Article III. See also Panama Canal Act of 1979, Pub. L. No. 96-70, § 1101, 93 Stat. 456 (22 U.S.C. 3611).

other charges on gifts or inheritance or on personal property, the presence of which within the territory of the Republic of Panama is due solely to the stay therein of such persons on account of their or their sponsor's work with the Commission.

2. Petitioners Robert O'Connor, Paul Coplin and Jack Mattox are United States citizens who were employed by the Commission during the relevant tax years.[3] The wages they received from the Commission were included in computing their federal income tax for years 1979 (Coplin), 1980 (Mattox) and 1981 (O'Connor and Mattox). Thereafter, petitioners filed claims for refund for the amount of tax paid with respect to income received from the Commission, urging that Article XV of the Agreement in Implementation of Article III of the Panama Canal Treaty exempted that income from domestic taxation. The Internal Revenue Service denied each of their claims, and each petitioner filed a suit for refund in the Claims Court (Pet. App. 2a).

The Claims Court rejected the government's argument that Article XV of the Implementation Agreement was not intended to restrict the right of the United States to tax its citizens. The Claims Court determined that, even though the Executive Branch had consistently interpreted the Agreement as implicating only Panamanian taxes, a broad, literal interpretation of the Implementation Agreement was required because the government presented "no evidence whatsoever as to the interpretation given this lan-

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[3] Gladys E. O'Connor, Patricia Coplin and Maria R. Mattox are parties to these suits because each filed a joint tax return with her husband. Unless otherwise stated, we will refer to Robert O'Connor, Paul Coplin and Jack Mattox as petitioners.

guage by Panama" (Pet. App. 1a-2a, 29a, 61a-66a, 68a-69a (emphasis omitted)). The court stated (*id.* at 38a) that "[w]ithout a statement from Panama it is of course difficult to be certain as to what its motivations might have been." Although acknowledging that the United States' position was "conceivable" and had "common sense appeal" (*id.* at 40a), the court concluded that several other "possibilities" as to Panama's motivations "come to mind" (*id.* at 38a-39a). And, based on its own "surmise and conjecture" (*id.* at 29a), the court rejected the Executive Branch's reading of the Agreement.

3. The Federal Circuit unanimously reversed. Shortly before oral argument in the court of appeals, the Foreign Minister of the Republic of Panama delivered to the United States government a diplomatic note confirming that the Foreign Ministry of Panama agreed with the United States that Article XV of the Implementation Agreement was not intended to affect United States taxation of Commission employees (U.S. App. 4a-9a; Pet. App. 5a). The note stated (U.S. App. 4a) that Article XV(2) was:

> discussed, negotiated, and drafted exclusively with respect to the tax exemptions that the Republic of Panama would grant to United States-citizen employees of the Panama Canal Commission and their dependents * * *. The aforementioned provision[] resulted from negotiations which did not deal with the United States authority to tax the individuals mentioned therein.

Petitioners moved to strike the official statement of the Panamanian government. In denying that motion, the court stated that its role in treaty matters was limited "'to giving effect to the intent of the Treaty parties'" (Pet. App. 6a, quoting *Sumitomo*

Shoji America, Inc. v. *Avagliano*, 457 U.S. 176, 185 (1982)). Since the treaty partners agreed that Article XV of the Implementation Agreement did not exempt the salaries paid to the Commission's United States citizen employees from United States taxation, the trial court's contrary determination was reversed (Pet. App. 6a-7a). In a concurring opinion, three members of the five-judge panel concluded (Pet. App. 8a) that "[a] complete reading of the record [before the Claims Court], the treaty and the Implementation Agreement" indicates that Article XV has no bearing on the power of the United States to tax its own citizens and that it is not necessary to consider the note from the Panamanian government to reach that result since the note "merely confirms the most reasonable interpretation of the Article."

SUMMARY OF ARGUMENT

The world-wide income of United States citizens is subject to taxation by the United States, regardless of the person's residence or the source of such income. Exemption from taxation is a matter of legislative grace and may never be founded upon implication. Rather, such exemption must be granted expressly and explicitly. Petitioners here claim that Article XV of the Agreement in Implementation of Article III of the Panama Canal Treaty constitutes such an express exemption, permitting them to avoid all taxation on the salaries received from the Commission. As the Federal Circuit properly recognized, the Agreement grants no such exemption.

This Court has long recognized that the judicial role in interpreting an international agreement, whether a treaty or an executive agreement (as is the Implementation Agreement), is limited to giving

effect to the intent of the treaty partners. In determining that intent, this Court has not limited its examination to the language employed, but has relied upon the history of negotiations and the proceedings before the Senate. Nor has this Court confined its search to documents presented to lower courts; it has examined records and expressions of intent of a foreign government that were presented to it for the first time. In addition, this Court has repeatedly held that the interpretation placed on an agreement by the Executive Branch, "the Nation's organ for foreign affairs" (*Chicago & Southern Air Lines, Inc.* v. *Waterman Steamship Corp.*, 333 U.S. 103, 111 (1948)), is entitled to great weight. For that reason, deference to the Executive's view is the rule when the treaty partner is silent and even when it takes a view different from that taken by the United States. When, however, the parties to an international agreement agree as to the meaning of a treaty provision, this Court has held it inappropriate for any court to chart a different course.

The language of Article XV, the history surrounding its negotiations, and the proceedings leading to Senate ratification, all indicate that Article XV was not intended to restrict the right of the United States to tax its citizens working for the Commission, but rather was directed solely at defining the Panamanian tax status of the Commission, its agents and employees. Paragraph 2 (first sentence) of Article XV provides that "United States citizen employees and dependents shall be exempt from any taxes, fees, or other charges on income received as a result of their work for the Commission." If there is any doubt that, in context, this refers only to Panamanian tax, that doubt is resolved by the paragraph's following

sentence, which exempts United States citizens employed by the Commission "from payment of taxes * * * on income derived from sources outside * * * of Panama." To read paragraph 2 as implicating any taxes other than Panamanian taxes, as the petitioners do, would give credence to the argument that even interest earned on United States bank accounts and dividends paid by domestic corporations are exempt from United States as well as Panamanian income tax, while similar income earned in Panama would be subject to both Panamanian and United States taxation.

Petitioners' reading of the treaty not only leads to absurd results, but ignores the fact that exemption from United States taxation for the Commission's United States citizen employees was never the subject of negotiations. The record reflects that there were four drafts of Article XV prepared by the United States negotiators between June 26, 1977, and August 24, 1977. The initial draft and all subsequent drafts, including the one adopted, are virtually identical. The record further indicates that the United States and Panamanian negotiators engaged in discussions over Panamanian taxation of the Commission's United States employees. But no mention was made of an exemption from United States taxation, as the note from the Panamanian government confirms.

Consistently with the history of the negotiations, the State Department advised the Senate that paragraph 2 of Article XV related exclusively to exemption from Panamanian income taxes, and not to United States income taxes. The Senate obviously was satisfied with the State Department's view, for it requested no action. The Senate committee report ac-

companying the Treaty specified that the State Department's comments were to be considered "an authoritative source of information with respect to the negotiating background and interpretation of the Treaties."

There is no factual basis for petitioners' speculation as to what might have transpired in the negotiations. Nor is there anything in the post-ratification history of the administration of the Treaty and Implementing Agreement to lend credence to petitioners' argument. The United States has always interpreted the agreement to provide for exemption from Panamanian taxation only. Even without regard to the Panamanian government's interpretation, such an Executive Branch interpretation of an international agreement is entitled to great deference.

In any event, the Government of Panama has now provided the United States with its official interpretation of the relevant provision. That interpretation is completely in accord with the interpretation advanced by the United States and adopted by the court below. Under the well-established teachings of this Court, the court of appeals properly considered the interpretation of the Panamanian government and correctly adhered to the mutual interpretation of the two parties to the Agreement.

ARGUMENT

THE INCOME PETITIONERS EARNED FROM THE PANAMA CANAL COMMISSION WAS NOT EXEMPT FROM UNITED STATES TAXATION

A. Petitioners' Income Is Fully Subject To Tax Under The Internal Revenue Code

The world-wide income of United States citizens is subject to taxation by the United States regardless of the citizen's residence or the source of such income. Internal Revenue Code of 1954, 26 U.S.C. 1; *Cook* v. *Tait*, 265 U.S. 47, 56 (1924). As has long been recognized, exemption from taxation is a matter of legislative grace and must be granted explicitly. *HCSC-Laundry* v. *United States*, 450 U.S. 1, 5 (1981); *Commissioner* v. *Glenshaw Glass Co.*, 348 U.S. 426, 429-430 (1955); *Helvering* v. *Northwest Steel Rolling Mills, Inc.*, 311 U.S. 46, 49 (1940); *United States Trust Co.* v. *Helvering*, 307 U.S. 57, 60 (1939). There is no merit to petitioners' claim that Article XV(2) of the Agreement in Implementation of Article III of the Panama Canal Treaty constitutes such an express exemption, permitting them to avoid all taxation on the salaries received from the Commission.[4]

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[4] Unless the petitioners' salaries are exempt under paragraph 2 of Article XV, the income earned by United States citizens from employment by the Commission would unquestionably be subject to tax. The basic exemption applicable for United States citizens employed abroad is set forth in 26 U.S.C. 911, 912. The exemption provided by Section 911 is specifically made inapplicable to amounts paid by the United States or an agency thereof. Since the Commission is an agency of the United States, income received by a United States citizen as compensation for his work for the Commis-

B. The Implementation Agreement Was Clearly Intended To Exempt United States Citizen Employees Of The Commission Only From Panamanian Taxes On Their Commission Salaries

1. *Controlling Principles Of Treaty Interpretation Require The Courts To Effectuate The Treaty Partners' Intent And To Give Great Deference To The Executive Branch In Determining That Intent*

Since the Implementation Agreement is an international executive agreement, its interpretation is subject to the same rules of construction applicable to treaties. *United States* v. *Pink*, 315 U.S. 203, 223-224, 227-230 (1942); *United States* v. *Belmont*, 301 U.S. 324, 330-332 (1937).

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sion would not be exempt from income tax under Section 911. *McCain* v. *Commissioner*, 81 T.C. 918, 921-924 (1983). The exemption provided in Section 912 for certain United States government allowances (*e.g.*, foreign areas allowances under certain statutes and cost-of-living allowances) is not applicable to the amounts involved in the instant case. See note 25, *infra*.

Nor do petitioners' salaries come within Section 931, which provides an exemption with respect to income derived from possessions of the United States. Although the term "possession of the United States" included the Canal Zone (Treas. Reg. 1.931-1(a)(1)), the salary or other compensation paid for services performed by a citizen of the United States as an employee of the United States government or of its agency was deemed for the purpose of Section 931 to be derived from sources within the United States (Section 931(h)) and thus did not fall within the exemption provided by Section 931. In any event, Section 931 is an historical relic as far as this case is concerned, for the Canal Zone ceased to be a possession of the United States as of October 1, 1979. (There is no claim in this case involving income earned prior to October 1, 1979.)

As this Court has indicated, the role of a court in interpreting international agreements is "limited to giving effect to the intent of the Treaty parties." *Sumitomo Shoji America, Inc.* v. *Avagliano*, 457 U.S. 176, 185 (1982). See also *In re Ross*, 140 U.S. 453, 475 (1891). In determining that intent, courts appropriately examine not only the language used in the treaty, but also the context in which the language is used, the history of negotiations underlying the agreement, and the proceedings before the Senate. See *Air France* v. *Saks*, No. 83-1785 (Mar. 4, 1985), slip op. 3-4, 6-8; *Sumitomo Shoji America, Inc.* v. *Avagliano*, 457 U.S. at 180, 184-185; *Factor* v. *Laubenheimer*, 290 U.S. 276, 294-295 (1933); *Nielsen* v. *Johnson*, 279 U.S. 47, 52 (1929). Because "few words possess the precision of mathematical symbols" (*Boyce Motor Lines, Inc.* v. *United States*, 342 U.S. 337, 340 (1952)), the judicial inquiry does not end with even seemingly unambiguous language where other factors, such as the conditions and circumstances existing at the time the provision was adopted, the question the provision was meant to resolve, and the practical construction adopted by the parties, indicate that an overly narrow reading of the language will not advance the treaty's aims. *Factor* v. *Laubenheimer*, 290 U.S. at 294-295; *In re Ross*, 140 U.S. at 475; *Great-West Life Assurance Co.* v. *United States*, 678 F.2d 180, 183 (Ct. Cl. 1982).[5] See also *FDIC* v. *Philadelphia Gear Corp.*, No. 84-

[5] In *Great-West Life Assurance Co.*, the language of the treaty contained no facial ambiguity and the parties stipulated that all of the literal requirements of the treaty provision granting an exemption were met. After examining the Senate Foreign Relations Committee report on the treaty and the accompanying documents from the State Department, the court held that the language of the treaty was not intended to grant the broad exemption claimed by the taxpayer.

1972 (May 27, 1986), slip op. 5-6. Thus, when confronted with two "plausible" readings of the language in a Treaty, this Court must "view the Treaty in the light of its entire language and history." *Kolovrat* v. *Oregon*, 366 U.S. 187, 192-193 (1961). See *TWA* v. *Franklin Mint Corp.*, 466 U.S. 243 (1984); *Washington* v. *Fishing Vessel Ass'n*, 443 U.S. 658, 675 (1979).

While the ultimate goal of adjudication is to give effect to the treaty partners' intentions, it has long been settled that the construction of an international agreement by the Executive Branch is entitled to great deference by the courts in determining that intent. *Sumitomo Shoji America, Inc.* v. *Avagliano*, 457 U.S. at 180-184; *Kolovrat* v. *Oregon*, 366 U.S. at 194; *Factor* v. *Laubenheimer*, 290 U.S. at 295. It is, after all, the Executive Branch that is charged with conducting foreign affairs. See *United States* v. *Curtiss-Wright Export Corp.*, 299 U.S. 304, 319-321 (1936); cf. *Haig* v. *Agee*, 453 U.S. 280, 293 (1981). For that reason, deference is the rule even when the treaty partner takes a view different from that taken by the United States.[6] *Factor* v. *Laubenheimer*, 290 U.S. at 298; *Charlton* v. *Kelley*, 229 U.S. 447, 473 (1913); *Whitney* v. *Robertson*, 124 U.S. 190, 194-195 (1888); *United States* v. *A.L. Burbank & Co.*, 525 F.2d 9, 15 (2d Cir. 1975), cert. denied, 426 U.S.

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[6] Contrary to petitioners' contention (O'Connor Br. 33), these controlling principles of treaty interpretation do not depend upon whether the government is a party to the case; they are applicable in all cases involving an international agreement, for the objective remains the same: to effectuate the purpose of the signatories. *Great-West Life Assurance Co.* v. *United States, supra; United States* v. *A.L. Burbank & Co., supra; United States* v. *County of Arlington*, 669 F.2d 925 (4th Cir.), cert. denied, 459 U.S. 801 (1982).

934 (1976). When, as here, "the parties to a treaty both agree as to the meaning of a treaty provision, and that interpretation follows from the clear treaty language, [the judiciary] must, absent extraordinarily strong contrary evidence, defer to that interpretation" (*Sumitomo Shoji America, Inc.* v. *Avagliano*, 457 U.S. at 185).[7]

2. *The Language And Context Of The Implementation Agreement Demonstrate That No Exemption From United States Taxation Was Intended*

Any effort to ascertain the intent of the signatories to an agreement must begin with the language they employed. "The clear import of treaty language controls unless 'application of the words of the treaty according to their obvious meaning effects a result inconsistent with the intent or expectations of its signatories.'" *Sumitomo Shoji America, Inc.* v. *Avagliano*, 457 U.S. at 180, quoting *Maximov* v. *United States*, 373 U.S. 49, 54 (1963).

The language of Article XV shows that it was not intended in any way to restrict the right of the United States to tax its citizens working for the Commission. When read as a whole the article clearly reflects its purpose: to exempt the Commission and its United States citizen employees from taxation by

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[7] In searching for guides to the intent of the treaty partners, this Court has not confined itself to documents presented to lower courts, but has examined records and expressions of intent of both the United States and of a foreign government that were presented to it for the first time. *Sumitomo Shoji America, Inc.* v. *Avagliano*, 457 U.S. at 184 n.9; *Factor* v. *Laubenheimer*, 290 U.S. at 295 (the Court's order for reargument invited counsel to conduct a further search through available diplomatic records and correspondence); *United States* v. *Reynes*, 50 U.S. (9 How.) 127, 147-148 (1850).

Panama on income or property other than private business activities in Panama unrelated to the Commission.[8] Although the term "Panamanian taxes" does not appear anywhere in the article, it is clear from the context that only such taxes are intended. Thus, paragraph 1 exempts the Commission, its contractors and subcontractors from payment "in the Republic of Panama of all taxes, fees or other charges on their activities or property." Paragraph 3 exempts United States citizen employees of the Commission and their dependents from payment of taxes, fees or other charges on "gifts or inheritance or on personal property, the presence of which within the territory of the Republic of Panama is due solely to * * * their own or their sponsor's work for the Commission."[9] The first sentence of paragraph 2, which

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[8] Petitioners contend (O'Connor Br. 34; Coplin Br. 5; Mattox Br. 7, 11), in effect, that analysis should begin and end with the phrase "any taxes," which they submit is unambiguous. But, as this Court has noted in other contexts, the word "any" is often an unclear guide to underlying intent. *E.g.*, *Ladner* v. *United States*, 358 U.S. 169, 170 n.1, 173 (1958) ("congressional meaning is plainly open to question on the face of the statute" (*i.e.*, "any person")); *Bell* v. *United States*, 349 U.S. 81, 83-84 (1955) (allowable unit of prosecution ambiguous under statute referring to "any woman or girl"); see *United States* v. *Kinsley*, 518 F.2d 665, 667-668 (8th Cir. 1975) (collecting cases).

More specifically, in cases involving treaty interpretation this Court has rejected efforts to wrench snippets of language out of context. The Court stated in *Petersen* v. *Iowa*, 245 U.S. 170, 173 (1917), that:

> if the mere letter of portions of the article when separately considered would leave room for any doubt on the subject, it would be dispelled by the context * * *.

[9] It is undisputed (Pet. App. 25a; O'Connor Br. 34) that paragraph 3 precludes only Panamanian taxation. Yet the language says the exemption is "from taxes," not merely

is at issue in this case, provides that "United States citizen employees and dependents shall be exempt from any taxes, fees, or other charges on income received as a result of their work for the Commission." If there is any doubt that, in context, this refers only to Panamanian tax, that doubt is resolved by the paragraph's following sentence, which exempts United States citizens employed by the Commission "from payment of taxes * * * on income derived from sources outside * * * Panama." To read paragraph 2 as granting an exemption from United States as well as Panamanian taxation would give credence to the argument that even interest earned by United States citizens from United States bank accounts and dividends paid to those citizens by United States corporations are exempt from United States income tax. Yet, similar income generated in Panama would be subject to both Panamanian and United States taxation (with a foreign tax credit being given by the United States under 26 U.S.C. 33 and 901 for the Panamanian taxes).

Such an irrational pattern of taxation was clearly never intended by the signatories. Accordingly, without even considering the Panamanian diplomatic note, a large majority of courts (and the majority of judges on the Federal Circuit panel) has concluded that Article XV focuses exclusively on Panamanian taxation.[10] As those courts have held, the article's

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Panamanian taxes. That Panamanian taxes alone are precluded is gathered from the context. Further, no one disputes that paragraph 1 implicates only Panamanian taxation.

[10] The Tax Court and many district courts have interpreted Article XV, paragraph 2, of the Implementing Agreement to exempt salaries of United States citizen employees of the Commission from Panamanian income tax, not from United States income tax. *Smith* v. *Commissioner*, 83 T.C. 702

purpose is to extend protection to United States citizens employed by the Commission (a United States government agency) from taxation by Panama—just as employees of United States government agencies pay no income tax to foreign host-countries around

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(1984); *McCain* v. *Commissioner, supra; Bergmann* v. *Commissioner*, 50 T.C.M. (CCH) 158 (1985); *Vamprine* v. *Commissioner*, 49 T.C.M. (CCH) 210 (1984), appeal pending, No. 85-4150 (5th Cir.); *Collins* v. *Commissioner*, 47 T.C.M. (CCH) 713 (1983); *Rego* v. *United States*, 591 F. Supp. 123 (W.D. Tenn. 1984); *Stabler* v. *United States*, 84-1 U.S. Tax Cas. (CCH) ¶ 9153 (N.D. Tex. Nov. 30, 1983); *Hollowell* v. *United States*, 84-1 U.S. Tax Cas. (CCH) ¶ 9142 (M.D. Fla. Nov. 21, 1983); *Watson* v. *United States*, 592 F. Supp. 701 (W.D. Wash. 1983); *Corliss* v. *United States*, 567 F. Supp. 162 (W.D. Ark. 1983); *Highley* v. *United States*, 574 F. Supp. 715 (M.D. Tenn. 1983); *Pierpont* v. *United States*, 83-2 U.S. Tax Cas. (CCH) ¶ 9647 (D.S.C. Oct. 3, 1983); *Snider* v. *United States*, 53 A.F.T.R.2d (P-H) 349 (W.D. Wash. Sept. 23, 1983); *Stokes* v. *United States*, 83-2 U.S. Tax Cas. (CCH) ¶ 9644 (W.D. Wash. Aug. 29, 1983); unreported opinions in *Skrable* v. *United States*, No. 84-3053 (W.D. Ark. May 13, 1985), appeal pending, No. 85-1743WA (8th Cir.), and in *Foster* v. *United States*, No. 84-952-CIV-T-13 (M.D. Fla. Apr. 1, 1985), appeal pending, No. 85-3446 (11th Cir.). See also *Billman* v. *Commissioner*, 83 T.C. 534, 541 n.6 (1984). To the contrary, see *Harris* v. *United States*, 585 F. Supp. 862, 863 (N.D. Ga. 1984), aff'd, 768 F.2d 1240 (11th Cir. 1985), petition for cert. pending, No. 85-1011. In *Swearingen* v. *United States*, 565 F. Supp. 1019 (D. Colo. 1983), the court held that an executive agreement (which the Implementation Agreement is) exempting United States citizens from taxation is not within the constitutional powers of the President. In addition, the Tax Court has recently held that in the virtually identical provision of Article XVI of the Agreement in Implementation of Article IV of the Panama Canal Treaty, Sept. 7, 1977, United States-Panama, T.I.A.S. No. 10032 (U.S. App. 2a-3a), United States citizen employees of the United States Armed Forces stationed in Panama are not exempt from United States taxation. *Rust* v. *Commissioner*, 85 T.C. 284 (1985).

the world. The purpose was not to relieve anyone of his duty to pay United States taxes.

Only by removing the words "any taxes" in the first sentence of paragraph 2 from their proper context can the petitioners argue that an exemption from United States taxes was created. To be sure, had the negotiators anticipated the question raised in this case they could have employed language that disposed of petitioners' contentions even more clearly. But the degree of precision even skilled draftsmen employ is generally a function of the draftsmen's perception of the precision needed to resolve the question at hand.[11]

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[11] Petitioners (O'Connor Br. 34-39) seek support for their interpretation, as did the Claims Court (Pet. App. 26a, 46a-47a), by looking at other provisions of the Treaty and at other agreements. While some portions of the Treaty refer expressly to Panamanian taxes, fees, etc., other provisions that clearly affect only Panamanian taxes are written in terms similar to paragraph 2 of Article XV. See Agreement in Implementation of Article III at Article XI(2)(h) (T.I.A.S. No. 10031) (contractors "shall be exempt from any taxes"); Article XIV(2)(b) (vehicles "shall not be assessed any license or registration fees"); Article XVI(2), (5)(a) and (c). In any event, that certain other provisions may have been written with more precision would, at most, support a tentative inference that the power of the United States to tax its citizens was implicated. But, as we have indicated (page 10, *supra*) such inferences cannot support an exemption from domestic taxation. See, *e.g.*, *HCSC-Laundry* v. *United States*, *supra*.

The model for the taxation sections of the Implementation Agreement was Article X of the Status of Forces Agreement with the Republic of China, Aug. 31, 1965, United States-Republic of China, 17 U.S.T. 373, T.I.A.S. No. 5986, terminated January 1, 1980 (C.A. App. 68, 70). Article X(2) (17 U.S.T. 381) of the Agreement with the Republic of China provides:

> Members of the United States armed forces, or the civilian component, and their dependents, shall be exempt from

See *Ex parte Peru*, 318 U.S. 578, 596-597 (1943) (Frankfurter, J., dissenting) ("Legislation by even the most competent hands, like other forms of com-

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> any direct tax imposed on income, except income derived from sources in the Agreement Area other than that resulting from services with or employment by the United States armed forces or by the corporations provided for in Article XII of this Agreement or by other United States governmental establishments in the Agreement Area.

That provision, like other Status of Forces Agreements (SOFAs) (C.A. App. 88), was designed to exempt from host-country income taxes, service-related salaries earned in the host country and non-host country source income. Accordingly, neither that Agreement nor any of the many other SOFAs employing similar or more precise terminology has ever been construed to provide an exemption from United States taxation.

More directly, the language of the provisions in question derives from paragraph 2 of Article XVI of the Agreement in Implementation of Article IV of the Panama Canal Treaty (C.A. App. 88-89), which was modeled after the foregoing provision. That paragraph provides:

> Members of the Forces or the civilian component, and dependents, shall be exempt from any taxes, fees or other charges on income received as a result of their work for the United States Forces or for any of the service facilities referred to in Article XI or XVIII of this Agreement. Similarly, as is provided by Panamanian law, they shall be exempt from payment of taxes, fees or other charges on income derived from sources outside the Republic of Panama.

The Tax Court in *Rust* v. *Commissioner*, *supra*, rejected the taxpayer's argument that this paragraph exempts from United States taxation the salaries of the members of the United States armed forces, the civilian component and dependents. Even the Claims Court opined (Pet. App. 45a-46a) that exemption from United States taxation was not provided by the first sentence of that provision, which is identical in all relevant respects to the provision at issue here.

position, is subject to the frailties of the imagination. Concentration on the basic aims * * * inevitably overlooks lacunae and ambiguities which the future reveals and which the future must correct."). And, as we now show, the language chosen in paragraph 2 was suitable to resolve the question under discussion —whether the wages of United States citizens employed by the Commission were to be subject to income taxation by Panama or any Panamanian authorities or agents.

3. *The Context In Which The Agreement Was Negotiated, The History Of The Negotiations And The Basis Upon Which The Senate Approved The Panama Canal Treaty, Confirm The Government's Interpretation That Exemption From Panamanian Taxes, Not United States Taxation, Was Intended*

The construction placed upon the Treaty by the United States, as well as by the Republic of Panama, is confirmed by the context in which Article XV was negotiated and by the negotiating history. Between February 26, 1904, and September 30, 1979, the United States exercised rights, power and authority over the Canal Zone that "it would possess and exercise if it were the sovereign" of the Zone "to the entire exclusion of the exercise of the Republic of Panama of any such sovereign rights, power or authority." Isthmian Canal Convention, Nov. 18, 1903, United States-Panama, art. III, 33 Stat. 2235, T.S. No. 431; 1977 Treaty, art. I(1)(a). See also, Treaty of Friendship and Cooperation with Panama, Mar. 2, 1936, United States-Panama, art. I, 53 Stat. 1807, T.S. No. 945. For several decades prior to entering into the 1977 Treaty, the United States operated the Panama Canal through its agent the Panama Canal Company

(Canal Company) and its predecessors. See Canal Zone Code, Pub. L. No. 87-845, § 61, 76A Stat. 8.[12]

The salaries paid United States citizen employees by the Canal Company were subject to United States taxation.[13] *McCain* v. *Commissioner*, 81 T.C. 918, 921-924 (1983); *Collins* v. *United States*, 299 F.2d 949 (Ct. Cl. 1962); Rev. Rul. 58-472, 1948-2 C.B. 30; 8 J. Mertens, *Law of Federal Income Taxation* § 45-61 (rev. ed. 1978). Moreover, pursuant to treaty, United States citizens residing in Panama and working for the Canal Company were not subject to Panamanian income taxes.[14] When the 1977

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[12] Title 2 was repealed by Section 3303(a)(1) of the Panama Canal Act of 1979, Pub. L. No. 96-70, 93 Stat. 499.

[13] Salaries paid to United States citizens working in a possession of the United States for the United States government or one of its agencies, like the Canal Company, were exempted from United States taxation between 1921 and 1951 if the employees otherwise satisfied the provisions of 26 U.S.C. (1940 ed.) 251(a) and its predecessors. Rev. Rul. 58-472, 1958-2 C.B. 30, 32. The provisions of Section 251(a) of the 1939 Code were first enacted in Section 262 of the Revenue Act of 1921, ch. 136, 42 Stat. 271, and were made effective as of January 1, 1921, by Section 263 of that Revenue Act (42 Stat. 271). Section 251 of the 1939 Code was amended by Section 220 of the Revenue Act of 1950, ch. 994, 64 Stat. 944, to preclude employees of the United States government or one of its agencies from obtaining the benefits of Section 251 of the 1939 Code. H.R. Rep. 2319, 81st Cong., 2d Sess. 58, 103 (1950); S. Rep. 2375, 81st Cong., 2d Sess. 48, 100 (1950). The relevant provisions of Section 251 of the 1939 Code and the exclusion of those benefits for employees of the United States government or of its agencies are found in Section 931 of the 1954 Code.

[14] Isthmian Canal Convention, art. X, 33 Stat. 2237; Treaty of Friendship and Cooperation with Panama, art. IV, 53 Stat. 1813; Treaty of Mutual Understanding and Cooperation with

Treaty became effective on October 1, 1979, the authority to exercise full rights of sovereignty in the area of the former Canal Zone was restored to the Republic of Panama (art. I(2) (T.I.A.S. No. 10030)), and the United States was granted the right to manage, operate and maintain the Panama Canal (art. III(1)).[15] The Commission became the agency through which the United States manages, operates and maintains the Panama Canal. Panama Canal Act of 1979, Pub. L. No. 96-70, § 1101, 93 Stat. 456 (22 U.S.C. 3611); 1977 Treaty, art. III(3), T.I.A.S. No. 10030. In changing the status of the United States' rights from plenary authority (as "if it were the sovereign" over a segment of Panamanian territory) to particular, functionally defined rights within a foreign nation, an obvious focus of concern was how Panama would thereafter treat the United States' agency and the agency's employees and their dependents who are United States citizens living and working under Panamanian jurisdiction. *Corliss* v. *United States*, 567 F. Supp. 162 (W.D. Ark. 1983); *McCain* v. *Commissioner*, 81 T.C. at 928. It is within that context that the parties agreed (1977 Treaty, art. III(9)) to provide for "the rights and legal status of United States Government agencies and employees operating in the Republic of Panama" in an implementing agreement. Thus, the stated raison d'etre of the Implementation Agreement, of which Article XV is a part, is to define rights of United States citizens with respect to Panama.

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the Republic of Panama, Jan. 25, 1955, United States-Panama, art. II, 6 U.S.T. 2273, T.I.A.S. No. 3297.

[15] The Treaty's Preamble acknowledges "the Republic of Panama's sovereignty over its territory."

It is fully consistent with this purpose that the negotiating history leading to the signing of the Panama Canal Treaty and its implementing agreements, and the ratification proceedings before the United States Senate, show that insofar as income taxes are concerned, the discussion focused solely on exempting from Panamanian taxation the salaries paid to the Commission's United States citizen employees. There was no discussion of exemption from United States taxation on Commission salaries or on other United States source income (C.A. App. 102, 105, 109, 112, 123-129, 152, 154, 162). As the record shows, the negotiations concerning Article XV, which was drafted by the United States (C.A. App. 17-18, 25-26, 192), took place during the so-called May 1977 round of negotiations that lasted at least into August 1977 (*id.* at 26, 63, 69, 113). The first internal United States draft (then numbered Article XVIII), dated June 26, 1977, provided in pertinent part as follows (C.A. App. 26, 71, 74):

> TAXATION
>
> 1. By virtue of this Agreement, the Canal Administration is exempt from payment in the Republic of Panama of all taxes, fees or other charges on its activities or property, including those imposed through contractors or subcontractors.
>
> 2. United States citizen civilian employees, and dependents, shall be exempt from any taxes, fees, or other charges on income received as a result of their work for the Canal Commission. Similarly, as is provided by Panamanian law, they shall be exempt from payment of taxes, fees or other charges on income derived from sources outside the Republic of Panama.

3. United States citizen employees, and dependents, shall be exempt from taxes, fees or other charges on gifts or inheritance or on personal property, the presence of which within the territory of the Republic of Panama is due solely to the stay therein of such persons on account of their or their sponsor's work with the Canal Administration.

At the June 30, 1977, negotiating session, the Panamanians pressed to tax the salaries of the Commission's United States citizen employees (C.A. App. 113, 116-117). The United States negotiators said that Panamanian taxation of those salaries would pose a great problem for the United States because "No employee of * * * the United States Government or of a government agency, is now subject to taxes in a foreign country; * * *" (*id.* at 115). The Panamanian negotiator suggested that perhaps the United States could concede primary taxing jurisdiction to Panama on such salaries through a tax credit mechanism (*i.e.*, the United States would tax the income, but give a credit for Panamanian taxes) (*id.* at 116-117). The United States said that no final answer could yet be given (*id.* at 115).

The second internal United States draft of Article XV (then Article XVIII) is dated July 10, 1977 (C.A. App. 75), and provides in pertinent part (*id.* at 77):

TAXATION

* * * * *

2. United States citizen civilian employees, and dependents, shall be exempt from any taxes, fees, or other charges on income received as a result of their work for the Panama Canal Administration. Similarly, they shall be exempt from payment of taxes, fees or other charges on income

derived from sources outside the Republic of Panama.[16]

* * * * *

At the July 11, 1977, negotiating session, the Panamanians continued to press the United States to allow Panama to tax the salaries of the Commission's United States citizen employees (C.A. App. 119-121). By then, the United States' position had hardened. Ambassador Linowitz stated (*id.* at 127):

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[16] Petitioners note that the second sentence of the first draft of Article XV(2) contained the phrase "as is provided by Panamanian law." Petitioners (O'Connor Br. 47; Coplin Br. 14-15) argue that the omission of that phrase indicates that a compromise was reached to exempt Commission salaries from United States taxation.

Petitioners read more into the removal of that phrase than the record will bear. The phrase merely reflected the fact that Panama, at the time that the agreements were negotiated, did not impose a tax on non-Panamanian source income. Removal of the phrase referring to Panamanian law assured the United States that if Panamanian law ever changed, Panama would still be under an international obligation to exempt from taxation the non-Panamanian source income earned by the United States citizen Commission employees.

In addition, as in paragraph 2 of Article XV, the term "any taxes" is used in paragraph 2 of Article XVI of the Agreement in Implementation of Article IV (relating to military matters). But again, in context, the taxes referred to are those of the host country in which the United States citizen is sent as an employee of the United States government or its agency, and not income taxes imposed upon United States citizens by the United States government. During the negotiations of the Panamanian taxation issue, the Panamanian negotiators recognized that the language of the SOFA was designed to exempt Defense Department personnel from Panamanian tax (C.A. App. 141). Adoption of similar language for Commission employees was intended to have the same effect and not a new effect—one never discussed—of exempting such employees from United States taxes.

> Now, on the income-tax question we do not have a paper. We have had very extensive discussions within our Government and analyses by the Treasury Department, the Internal Revenue Service, and other groups to determine whether there is a way of responding favorably to your suggestion without raising very formidable problems in other parts of the world. We have been advised that the problem is one that we cannot deal with as you have proposed. The taxation of the income received by U.S. employees from the United States Government, wherever earned, would run counter to the policy that the United States has adopted throughout the world; and this would be the first effort to have a breach in that kind of a relationship. And, therefore, we have no authority to accede to your request on this score.
>
> I can assure you we have tried in every way possible to explore the possibility; and, indeed, it is still being studied in some places in our Government. But I would be misleading you if I told you there is anything except a uniformly discouraging response that we have been receiving.

On July 12, 1977, the Panamanians again unsuccessfully urged the United States to agree that Panama could tax the salaries of the Commission's United States citizen employees (C.A. App. 134-141).

The next United States draft of Article XV (still Article XVIII) is dated July 13, 1977, and is identical to the July 10 draft (C.A. App. 78, 81). It was this draft that the United States first proposed to the Panamanian negotiators (*id.* at 26). On July 14, 1977, the Panamanians again tried without success

to persuade the United States to change its position on Panamanian taxation (C.A. App. 142-147).[17]

Whether the issue of taxation was again taken up is not clear (C.A. App. 148-149, 153-154, 157-158). But it is clear that nothing in the negotiating history suggests that anything other than the question of exemption from Panamanian taxation was ever considered. There is no mention in any document (either internal position papers or transcripts of the negotiations) that exemption from United States taxation was ever discussed.[18] The final version of Article XV, which deleted the word "civilian" in paragraph 2, was accepted without comment by the Panamanians

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[17] Petitioners' suggestion (O'Connor Br. 9-11) that there was a difference between the position taken by the United States "in-house" and in the negotiations with Panama is erroneous and arises from petitioners' selective reading of the record. In any event, had such differences existed they would have been irrelevant.

A memorandum to the Secretary of State dated July 19, 1977, "in preparation for discussion of economic aspects of the Panama Canal negotiations" (C.A. App. 150-152), indicates that the United States could address some of the Panamanians' economic concerns by acquiescing in Panamanian taxation of United States employees, but that such acquiescence would set an unfortunate international precedent. See also memorandum dated July 21, 1977, to the effect that the Panamanian position on taxes should be rejected (C.A. App. 161-162).

[18] The negotiating history of Article XV, as reflected in available documents at the State Department, was made a part of the record in the courts below and is available for this Court's consideration. Certain portions of the documents submitted to the Claims Court remain classified (see *United States* v. *Curtiss-Wright Export Corp.*, 299 U.S. at 320-321) and under seal by order of the Claims Court.

in August 1977 (C.A. App. 82-85, 192).[19] Thus, the government of Panama accepted the text drafted by the United States to reflect the United States' position.

Contrary to petitioners' contention (O'Connor Br. 47; Coplin Br. 14), there was no substantive change between the initial United States proposal and the final version of Article XV, paragraph 2, with respect to the exemption from taxation of the Commission salaries paid to United States citizen employees (see note 16, *supra*). The negotiations related solely to exemption of those salaries from Panamanian taxation, and exemption from United States taxation was never considered.[20]

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[19] Contrary to petitioners' allegation (Coplin Br. 14-15), the record clearly indicates that August was not the first time that Panama had seen the text of Article XV. See C.A. App. 26. The affidavit of Dr. Lopez Guevara merely states that the *final* text was proposed in August, 1977 (C.A. App. 192).

[20] Even the affidavit of Dr. Lopez Guevara, upon which petitioners rely, does not state that United States taxation was ever discussed (C.A. App. 192). His affidavit, as well as that of Michael G. Kozak (a member of the United States negotiating team) (*id.* at 27-28, 87-89), states that exemption only from Panamanian taxation was discussed. The Lopez Guevara affidavit provides only a personal interpretation of Article XV and states the affiant's belief that the Panamanian government would agree. He does not state, as petitioners indicate (O'Connor Br. 14), that Panama actually took the position that United States taxation was covered. His personal interpretation is of little value under the rules of treaty construction and his prophecy as to the view the Panamanian Government would take has not been borne out.

In addition to the affidavit of Dr. Lopez Guevara, the petitioners produced sworn statements from Messrs. Tack and Lakas (C.A. App. 182-191). Those statements have no probative value. Mr. Lakas' statement relies upon the response of

The Senate Committee on Foreign Relations held extensive hearings on the Panama Canal Treaty and its implementing agreements. Consistently with the history of the negotiations cited above, Herbert J. Hansell, Legal Adviser of the Department of State, testified (*Panama Canal Treaties: Hearings Before the Senate Comm. on Foreign Relations*, 95th Cong., 1st Sess. Pt. 1, at 214 (1977)) that "[w]ith regard to exemption from Panamanian taxes, the implementing agreements provide exemption from Panamanian taxes for U.S. agencies and their personnel, including dependents, and contractors." Senator Stone questioned Mr. Hansell on the point (*id.* at 268; U.S. App. 10a-12a (emphasis added)):

> Senator STONE. I think it was article XV, section 1 that raised an interesting question. I will read it to you. "By virtue of this agreement the Commission, its contractors and subcontractors are exempt from payment in the Republic of Panama of all taxes, fees, or other charges on their activities or properties." *Then, in No. 2, referring to U.S. citizen employees and depend-*

Mr. Tack. But Mr. Tack was not even involved in the negotiations of Article XV. Rather, Mr. Tack was involved in the treaty negotiations prior to 1977, before Article XV was negotiated.

The treatment of the Kozak affidavit by the Claims Court (Pet. App. 35a-36a n.16; Feb. 23, 1984 Tr. 31-32) and by the *Harris* court (768 F.2d at 1245) is wrong as a matter of law. Mr. Kozak, who is a deputy legal adviser of the Department of State, was one of the United States representatives responsible for drafting and negotiating the Panama Canal Treaty and its implementing agreements (C.A. App. 23, 27-29, 87-89, 156). The affidavit is clearly relevant to state the affiant's knowledge of what subjects were raised during the negotiations and the origins of the provision in question. *Sumitomo Shoji America, Inc.* v. *Avagliano*, 457 U.S. at 184 n.10.

ents, it says, "shall be exempt from any taxes, fees, or other charges on income received as a result of their work for the Commission. Similarly, they shall be exempt from payments of taxes, fees, or other charges on income derived from sources outside the Republic of Panama."

Of course, when that was announced, the press reported the glee of the Zonians that they were now exempt from U.S. income tax. When Senator Glenn asked you, are there any words that you would like to see in the treaty, I was just asking myself, would you like to see the words, United States, in there somewhere?

Mr. HANSELL. I am sorry to be a source of disappointment for the Panamanians [*sic*], but obviously *we are not entering into an agreement between the United States and Panama that would exempt U.S. citizens from U.S. tax. The purpose of this, of course, was to exempt them from Panamanian tax.*

* * * * *

Senator STONE. Wouldn't you think that we could put in the understanding that I suggested to you, the clarification of our interpretation which then, when ratified by the Congress, by the Senate, and deposited, would clarify that in a little more formal way than simple advices, since you don't want to put words back in the treaty through negotiation?

Mr. HANSELL. The one comment I would have with respect to that, and this relates to a couple of other points, is that we are dealing now with an internal U.S. matter, not a matter between the United States and Panama. That is, *we don't agree with Panama how we are going to tax our citizens. That is obviously an internal matter.* I would hope we could find ways of dealing with internal matters other than as understandings.

As the Tax Court commented in *McCain* v. *Commissioner*, 81 T.C. at 928 (footnote omitted)—

> This interchange confirms the position urged by * * * the Commissioner of Internal Revenue. In providing for the termination of more than 70 years of U.S. jurisdiction to exercise rights, power, and authority as "if it were the sovereign" and for the return of control over the Canal Zone to the Republic of Panama, the United States would be concerned how the Republic of Panama would treat U.S. citizen employees of the Panama Canal Commission, a U.S. agency. One area of particular concern would be the imposition by Panama of any taxes on the agency or its U.S. citizen employees. On the other hand, as pointed out by Mr. Hansell, the imposition of taxes by either sovereign on its own citizens would not have been of concern to the treaty negotiators. Clearly, the United States would have no interest in negotiating with the Republic of Panama on whether it may tax its own citizens.

See also *Corliss* v. *United States*, 567 F. Supp. at 164, 165.

The Senate report accompanying the Panama Canal Treaty confirms the point made by Mr. Hansell. In the section-by-section analysis of the Treaty and its implementing agreements, the report states (S. Exec. Rep. 95-12, 95th Cong., 2d Sess. 155 (1978)):

> Paragraph 2 exempts United States citizen employees and dependents from the imposition by Panama of taxes on income received as a result of their work with the Commission and on the income derived from sources outside Panama. Such persons are subject, however, to Panamanian taxation of any income derived from

> sources * * * [inside] [21] Panama, other than their employment with the United States Government.

The report (*id.* at 127) emphasized that the section-by-section analysis was [22]—

> prepared by members of the treaty negotiating team and * * * [has] been approved by the offices of the State and Defense Departments directly involved in the negotiations * * *. Accordingly, these comments may be considered as an authoritative source of information with respect to the negotiating background and interpretation of the Treaties.

One of the drafters of the section-by-section analysis (Mrs. Geraldeen G. Chester) drafted Article XV of the Implementing Agreement (C.A. App. 25-26, 46, 64).

The purpose of Mr. Hansell's testimony and the section-by-section analysis was to inform the Senate during its deliberations of what transpired in the negotiations and the interpretation placed upon the Treaty and the Agreements by the State Department. Forming, as they do, the contemporaneous construction placed upon the Treaty and Agreement by the bodies constitutionally charged with making and ratifying the treaty, they should be regarded as the prin-

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[21] As the court in *Corliss* pointed out (567 F. Supp. at 166 n.1), the report, in an obvious mistranscription, referred here to "income derived from sources outside Panama."

[22] The section-by-section analysis was prepared during the ratification proceedings in 1977 and sent to the Senate Foreign Relations Committee by letter dated December 23, 1977. *Panama Canal Treaties: Hearings Before the Senate Comm. on Foreign Relations*, 95th Cong., 1st Sess. Pt. 3, at 689, 709 (1977).

cipal guide to interpretation. See *Stabler* v. *United States*, 84-1 U.S. Tax Cas. (CCH) ¶ 9153 (N.D. Tex. Nov. 30, 1983).

Petitioners (O'Connor Br. 35 n.21; Coplin Br. 17, 33, 37-38; Mattox Br. 10-12) seek to turn Mr. Hansell's testimony on its head and transform his statement that a formal clarification was unnecessary into a concession that some domestic tax exemption springs from Article XV. A decision not to seek to enter into a formal understanding or clarification with the government of Panama after the negotiations had been concluded and the Treaty signed does not suggest that the negotiations involved exemption from United States taxation. Quite the contrary. The testimony before the Senate Foreign Relations Committee shows simply that the State Department believed that the subject of domestic taxation was not one on which clarification by Panama was warranted. The Senate obviously agreed with the State Department's view that the Treaty provided exemption from Panamanian taxation only (S. Exec. Rep. 95-12, *supra*, at 34) and did not request that the State Department seek clarification through a formal understanding with Panama. Had the Senate deemed clarification necessary, it could have requested further action, as it did with respect to other portions of the Panama Canal Treaty. See Reservations and Understandings; 124 Cong. Rec. 2693-2694, 10541 (1978). The Senate, however, concurred in the views expressed by the State Department. In these circumstances, Senator Stone's comment amounts, at most, to an inquiry by a single legislator concerning whether the meaning of Article XV(2) could usefully be clarified by a formal understanding. Nowhere, however, did Senator Stone, the Senate, or the Exec-

utive Branch ever contend that Article XV(2) in fact exempts United States citizens from United States taxation.

Petitioners (O'Connor Br. 35 n.21; Coplin Br. 33) further err in dismissing the section-by-section analysis as the product of two individuals who had not participated in the actual negotiations. The analysis was approved "by the offices of the State and Defense Departments directly involved in the negotiations" (S. Exec. Rep. 95-12, *supra*, at 127). Further, Article XV was drafted by one of the authors of the section-by-section analysis. The drafting of the provision in question and the section-by-section analysis was not done in vacuo. Like the testimony of Mr. Hansell, the section-by-section analysis was prepared by the State Department to inform the Senate about the negotiations, "not to aid the Internal Revenue Service in these cases." *Stabler* v. *United States*, 84-1 U.S. Tax Cas. at 83,185 n.4.

Nor is there any merit to petitioners' argument (O'Connor Br. 22-23, 42, 46-49; Coplin Br. 26) that Panama might have sought to have the United States exempt United States citizens from taxation as a compromise to break a diplomatic stalemate. First, petitioners' speculation is negated by the negotiating history which shows that there was no substantive change between the first internal United States draft of Article XV, prepared before the negotiations, and the final language. The negotiations related solely to the question of Panamanian taxation. At no time did Panama object to the imposition of United States taxes on any of the items or activities which, under paragraphs 1, 2, and 3 of Article XV, were exempt from Panamanian taxation. Rather, the negotiating history of Article XV shows that the Panamanian negotiators were not concerned with the manner in

which the United States taxed its citizens, but simply wanted to secure for their government a similar authority to tax.[23] Indeed, the Panamanian suggestion that both Panama and the United States (with a tax credit for Panamanian tax) might tax the salaries of the Commission's United States citizen employees clearly shows that Panama anticipated that United States taxes would be paid, and that Panama was willing to have such employees taxed at the higher United States rates so long as Panama got the first bite.[24]

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[23] The Claims Court emphasized that Panama's motivation in seeking to tax employees of a United States government agency arose from notions of sovereignty rather than economics. Whatever Panama's motivation might have been, it conceded the substantive point in the negotiations. There is no dispute that petitioner's Commission salaries are exempt from Panamanian taxation. The question here is whether an exemption from United States taxes was created, an issue which does not implicate either Panamanian sovereignty (which was secured in the Treaty's Preamble and Article I) or Panamanian revenue (also dealt with elsewhere in the Treaty).

[24] The Claims Court (Pet. App. 37a-42a) and the *Harris* court (768 F.2d at 1245 n.8) cited other provisions of the Implementation Agreement and the Panama Canal Treaty or other treaties in support of their conclusion that the Agreement barred United States taxation. Those other treaties have little bearing here because, as this Court noted in *Sumitomo Shoji America, Inc.* v. *Avagliano*, 457 U.S. at 185 n.12, other provisions "although similarly worded, may have different negotiating histories."

The *Harris* court cited the fact that the United States assumed certain obligations with respect to Commission employees in Article X of the Treaty. But the obligation imposed upon the United States under Article X of the Treaty runs to all employees of the Commission, the former Canal Company and the former Canal Zone Government, not just to those who

Petitioners suggest (O'Connor Br. 48-49) that there were sound policy reasons for granting a domestic tax exemption to the salaries paid to (and non-

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are United States citizens. Indeed, Article X shows that the Republic of Panama was eager to decrease the number of United States nationals working for the Commission. Article X(3) limits the employment of non-Panamanians to persons with skills not available in Panama, and provides for training of Panamanian employees, and Article X(5) requires the periodic rotation of non-Panamanians hired after the Treaty became effective. Moreover, Panama was eager for the United States to grant liberal entitlements to annuitants and thus to encourage United States citizens to retire so that Panamanian replacements could be hired. See S. Exec. Rep. 95-12, *supra* at 30, 135-136. In view of Panama's desire to reduce the number of United States nationals working for the Commission, Panama could scarcely have desired a provision exempting United States citizens from United States taxation, a benefit that surely would have discouraged voluntary departures by employees who were United States citizens.

The Eleventh Circuit's opinion in *Harris* also cites (768 F.2d at 1245 n.8) Articles XII (Entry and Departure), XIII (Services and Installations), XIV (Licenses), XVI (Import Duties), XVIII (Claims), and XIX (Criminal Jurisdiction) of the Implementation Agreement as examples of "special inducements" to encourage United States citizens to continue in the employ of the Commission. As we have shown, however, the express language of the Treaty reflects Panama's contrary desire: to reduce non-Panamanian employment. In any event, to the extent that the cited portions of the Implementation Agreement grant rights to United States citizen employees, they involve rights granted by *Panama*, not by the United States (see page 22, *supra*). For example, Article XII provides that United States citizen employees "shall be exempted from fiscal charges relating to their entry, stay in, or departure from" Panama. Article XIV(4)(c) provides that United States citizen employees who hold licenses issued by the United States, a state, or the former Canal Zone government, shall be issued equivalent Panamanian licenses "without being subjected to new tests or payments of new fees." Article

Panamanian source income earned by) United States citizen employees of the Panama Canal Commission, while permitting United States taxation of Pana-

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XVI(3) provides that certain goods, such as furniture, household goods and personal effects, shall be exempt from "the payment of import duties or other import taxes." (As is the case with the provision at issue here, these articles refer generally to "fiscal charges" and "import duties or other import taxes" without specifically identifying Panama as the taxing sovereign because only Panamanian authority was under consideration.) The other articles cited in *Harris* relate primarily to the rights of the Panama Canal Commission.

The Claims Court attempted to buttress its position by looking to income tax conventions between the United States and foreign governments. But it found no instance in which the United States discussed with a foreign country the domestic tax implications to United States citizens of their employment in that country by an agency of the United States. Nor is there any relevance in this case of treaties that provide tax credits against United States taxes for taxes paid to the treaty partner on foreign-source income. From the United States' point of view, those treaty provisions are largely redundant of the foreign tax credit provision, which has long been part of domestic statutory law. See 26 U.S.C. 33, 901-905.

More to the point, the foreign tax credit provisions do not constitute a surrender by the United States of tax jurisdiction over its citizens. Rather, they merely recognize that when United States citizens are subject to the taxing jurisdiction of the country in which the income is derived, the United States requires its citizens to pay a combined United States and foreign tax at least equal to the United States tax. That is a far cry from exemption from domestic taxation.

In the Swedish and German tax conventions cited by the Claims Court (Pet. App. 40a-41a), the United States agreed to refrain from taxing United States citizens who operate shipping and air transportation business in the other signatory states. But, those treaties contain savings clauses under which the United States may, regardless of any provision of those conventions, determine the tax of its citizens as if the conven-

manian-source non-Commission income. In fact, considerations of tax policy would dictate just the opposite conclusion. United States citizens employed by

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tions had not come into effect (Income Tax Convention with the Federal Republic of Germany, July 22, 1954, United States-Germany, art. XVI(1)(a), 5 U.S.T. 2768, T.I.A.S. No. 3133, and Income Tax Convention with Sweden, Mar. 23, 1939, United States-Sweden, art. XIV, 54 Stat. 1759, T.S. No. 958). Therefore, the provisions relied upon by the Claims Court provide no exemption from all taxes.

The Claims Court's comments about tax sparing, whereby the United States treats a United States corporation or citizen as having paid a foreign tax even though the foreign government relieves them of that tax, are particularly off the mark. While the United States has negotiated a few treaties with tax-sparing provisions (see, *e.g.*, the Income Tax Convention with Pakistan, July 1, 1957, United States-Pakistan, art. XV(1), 10 U.S.T. 984, T.I.A.S. No. 4232), none of those treaties has been ratified. See *Hearings Before the Senate Foreign Relations Comm. on Various Tax Treaties*, 97th Cong., 1st Sess. 10 (1981) (statement of John Chapoton, former Assistant Secretary of the Treasury for Tax Policy). In connection with the recent agreement with the People's Republic of China, the United States merely set forth its agreement (in an exchange of letters) to grant the People's Republic of China a tax-sparing provision if such a provision is ever granted to another country. Indeed, the refusal of the United States to conclude a tax-sparing agreement suggests that complete exemption from taxation is not favored. See, *e.g.*, C.A. App. 159-160; S. Exec. Rep. 5, 90th Cong., 2d Sess. 12-13 (1968); Schreyer, *Income Tax Treaty Between the United States and China*, 1984 Tax Mgmt. Int'l J. 259, 263; *United States Taxation and Developing Countries* 311-312 (R. Hellawell ed. 1980).

Finally, we note that in its consideration of the Tax Reform Act of 1985 (H.R. 3838, 99th Cong., 1st Sess. (1985)), the House Ways and Means Committee included a provision, Section 642, dealing with the effect of the Panama Canal Treaty and the Implementation Agreement upon United States taxation of citizens. The Committee Report (H.R. Rep. 99-426,

the United States government or its agencies, such as the Commission, are subject to United States taxation wherever they reside. Consistency in treatment therefore argues strongly against domestic tax exemption. Indeed, Congress had earlier expressed its disapproval of exemptions for military and civilian employees of the United States government and its agencies residing in certain possessions of the United States. See note 13, *supra;* H.R. Rep. 2319, 81st Cong., 2d Sess. 58, 103 (1950); and S. Rep. 2375, 81st Cong., 2d Sess. 48, 100 (1950). And, while the exemption from domestic taxation petitioners seek here has no sound policy basis, there is even less basis for the further exemption from taxation that is implicit in their argument. If this Court accepts petitioners' reading of the first sentence of Article XV(2), they would presumably make the same argument to secure an exemption under the second sentence (relating to their non-Panamanian source income). There could be no conceivable policy justification for exempting United States citizen employees of the Commission from taxation on interest, dividends or rent received from United States sources while taxing them on the same

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99th Cong., 1st Sess. 427-428 (1985)), after noting the conflict among the courts, points out that petitioners' reading of the treaty "is patently inconsistent with the intent of the drafters and with the views of Congress as reflected in well-established U.S. treaty policy" and that granting a complete exemption from all taxes "would have been completely inconsistent with the treaty policy of the United States not to alter by treaty the U.S. tax treatment of U.S. persons, particularly with respect to income from services performed for the U.S. Government or its agencies." As the House Committee pointed out, there is nothing to indicate that Congress intended to contravene its well-established taxation policies in entering into the Panama Canal Treaty and its implementing agreements.

type of income derived from Panamanian sources. See pages 38-39 note 24, *supra*. And, as we have pointed out (page 36 note 24, *supra*), such an exemption would have been contrary to Panamanian interests.[25]

In sum, the language of the Implementation Agreement, as construed in its proper context, the negotiating history and the ratification proceedings all clearly show that the treaty parties never contemplated an exemption from United States taxation.

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[25] There is no merit to petitioners' contention (O'Connor Br. 42 n.23) that a binational tax exemption can be found in the congressional formula allowing Commission workers to receive a supplemental allowance. As pointed out above (page 21 & notes 4, 13, 14), United States citizens who worked for the Canal Company, which was the United States agency operating the Canal prior to October 1, 1979, were subject to United States income taxation but were not subject to Panamanian income taxation. The Canal Company had discretion to provide to United States citizen employees additional allowances above basic compensation "for taxes which operate to reduce * * * the employee's disposable incomes in comparison with the disposable incomes of those employees who are not citizens of the United States" and could pay "an overseas (tropical) differential" (see Canal Zone Code, ch. 7, § 146, 76A Stat. 17). The authorization to pay additional amounts subject to domestic taxation is clearly not the equivalent of a tax exemption. Indeed, the present Commission likewise has discretion to provide additional allowances as "overseas recruitment or retention differential" (Panama Canal Act of 1979, Pub. L. No. 96-70 § 1217, 93 Stat. 465). These provisions merely maintain the status quo ante. *Smith* v. *Commissioner*, *supra*, 83 T.C. at 710-715. The legislative history of the post-treaty amendments to the formula for computing the allowance indicates that Congress did not believe that a binational tax exemption was created by Article XV(2). See H.R. Rep. 96-98, 96th Cong., 1st Sess. Pt. 1, at 33, 54-55 (1979).

4. *The Court Below Properly Accorded Weight To The Executive's Interpretation Of The Treaty And Properly Implemented The Interpretation Agreed To By The Treaty Partners*

As set forth at the outset, it has long been settled that the construction of an international agreement by the Executive Branch is entitled to great deference by the courts. See, *e.g.*, *Sumitomo Shoji America, Inc.* v. *Avagliano*, 457 U.S. at 180-184. The United States has not wavered in its interpretation of Article XV, and its interpretation is well grounded in the language and history of the provision.

One of the fundamental reasons for deferring to the Executive's interpretation of international agreements is that it is the branch of government "charged with * * * negotiation and enforcement" of such agreements (*Sumitomo Shoji America, Inc.* v. *Avagliano*, 457 U.S. at 185) and cannot effectively discharge that constitutional function if its interpretations are lightly set aside. As this Court stated in *Haig* v. *Agee*, 453 U.S. at 292 (quoting *Harisiades* v. *Shaughnessy*, 342 U.S. 580, 589 (1952)): "matters relating to the conduct of foreign relations * * * are so exclusively entrusted to the political branches of government as to be largely immune from judicial inquiry or interference." See *Regan* v. *Wald*, No. 83-436 (June 28, 1984), slip op. 19. There is, accordingly, no merit to petitioners' suggestion that an inference should be drawn against the United States because it did not accede to the trial court's request that the Panamanian government be approached and its views solicited. It is, of course, an Executive function to determine when, under what circumstances, and on what subjects to approach foreign governments. In this case, the government chose not to raise with the Panamanian government, at the trial court's

behest, a wholly domestic issue that had not been the subject of negotiations. The Claims Court chose to draw "a negative inference" (Pet. App. 66a) and rejected the United States' longstanding, consistent interpretation. Instead, the court (although acknowledging that it had no indicia of Panama's official position) concluded that the agreement "should be construed as Panama would read it" (Pet. App. 68a). In effect, the court accorded greater deference to its speculation as to the meaning of the *silence* of the Panamanian government (which is not a party to these proceedings) than it did to the expressed views of the Executive Branch of the United States. Such an approach is contrary to the circumscribed judicial role in foreign affairs which this Court has endorsed; it also would lead to alarming implications for the conduct of the foreign relations of the United States.

In any event, by the time this case reached the court of appeals, the official Panamanian view was known. The Foreign Minister of the Government of Panama informed the United States in a note dated February 22, 1985, that the Government of the Republic of Panama concurred with the United States' interpretation that Article XV(2) of the Implementation Agreement provided an exemption from Panamanian taxes only. In accordance with the decisions of this Court (*e.g.*, *Sumitomo Shoji America, Inc.* v. *Avagliano*, 457 U.S. 183-184 (notes dated two months and five days before oral argument)), the court of appeals correctly considered this note.[26] Under well-

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[26] Contrary to petitioners' arguments (O'Connor Br. 31-32; Mattox Br. 13), there is no meaningful distinction between this case and *Sumitomo Shoji*. In *Sumitomo Shoji* the Japanese government informed the United States government of its interpretation in a note dated two months before oral argument in this Court and reinforced that view in a note

established rules, when both government parties to a bilateral international agreement concur in its interpretation, it is inappropriate for courts to chart a different course.

To do so would be to ignore the central fact that this case concerns the interpretation of a treaty, not just a dispute between private individuals. This court stated in *Choctaw Nation* v. *United States*, 119 U.S. 1, 28 (1886), that the rules governing public treaties "even in case of controversies between nations equally independent, are not to be read as rigidly as documents between private persons governed by a system of technical law, but in the light of that larger reason which constitutes the spirit of the law of nations." See *Air France* v. *Saks*, slip op. 3 (quoting *Choctaw Nation* v. *United States*, 318 U.S. 423, 431-432

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dated only five days before oral argument. The note in this case was dated ten days prior to argument in the court of appeals. Thus, there is no merit to the contention that the court of appeals should have ignored the Panamanian note, and even less merit to the notion that this Court should ignore a note submitted by a foreign government more than one year ago.

Nor is there merit to petitioners' claim that the court of appeals should have excluded the Panamanian note as a matter of judicial estoppel (O'Connor Br. 21, 24-26; Coplin Br. 40-42; Mattox Br. 17-18). That concept, which itself is not widely accepted (see *Konstantindis* v. *Chen*, 626 F.2d 933 (D.C. Cir. 1980)), precludes a party from taking different positions in separate causes of action based on the same facts. Of course, no two causes of action are here involved. The government has consistently urged that the Agreement does not bar United States taxation and has argued that the interpretation of the Executive Branch is to be accorded great weight, even if its treaty partner took a contrary position. That remains our position in this Court. As it happened, the treaty partner in this case has now explicitly concurred in the interpretation we urge. Certainly, this Court should not blind itself to this fact. See *Air France* v. *Saks*, slip op. 11.

(1943)) ("[T]reaties are construed more liberally than private agreements."). The ultimate aim of treaty interpretation is to effectuate the expectations of the treaty signatories, just as the ultimate inquiry in interpreting a statute is to effectuate the expectations of the legislative body. According to petitioners' position, the interpretation of an international agreement should vary from litigant to litigant, depending upon the record before the trial court. That argument falls of its own weight.[27]

Further, contrary to petitioners' contention (O'Connor Br. 29-31; Coplin Br. 27), the basis of a foreign government's interpretation is not open to challenge in a court of the United States. Once a foreign government presents a statement dealing with matters within its area of sovereign authority, American courts are obligated to accept that statement at face value as "conclusive." *United States* v. *Pink*, 315 U.S. at 220-221.[28] American courts long have recog-

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[27] Petitioners' argument would mean that in this case an international agreement should be interpreted to grant an exemption from United States taxation to six taxpayers because the Panamanian government expressed its views after the record in the trial court had closed, but that in all pending cases where the official Panamanian statement could be included in the record the same agreement would bar that exemption.

[28] Petitioners (O'Connor Br. 17 n.13, 42) misconstrue the purport of the Panamanian note. The purpose of that note is to present the Panamanian government's interpretation of the provision in question. Cross-examination is hardly called for. Although the note's import was the communication of the official government view and not the views of the individuals mentioned therein, it should be noted that among those consulted by the Foreign Minister of Panama was Dr. Escobar, who was the chief Panamanian negotiator during the period when the provision in question was negotiated (U.S. App. 8a; C.A. App. 113, 119, 134, 143, 144, 154; S. Exec. Rep. 95-12, *supra*, at 184).

nized that considerations of comity among sovereign nations—the idea that foreign nations are due deference when acting within their legitimate realm of authority—play a role in determining "the recognition which one nation allows within its territory to the legislative, executive or judicial acts of another nation." *Hilton* v. *Guyot*, 159 U.S. 113, 164 (1895). See genearlly *McCulloch* v. *Sociedad Nacional*, 372 U.S. 10 (1963); *Lauritzen* v. *Larsen*, 345 U.S. 571 (1953); *The Charming Betsy*, 6 U.S. (2 Cranch) 64 (1804).

In accordance with well-established canons governing the interpretation of international agreements, the position of the United States is supported by the language of the agreement, the negotiating history, and the uniform interpretation of both signatory powers. As the court of appeals properly held, petitioners are not entitled to a tax exemption to which the treaty partners never agreed.

CONCLUSION

The judgments below should be affirmed.
Respectfully submitted.

CHARLES FRIED
Solicitor General

ROGER M. OLSEN
Assistant Attorney General

LAWRENCE G. WALLACE
Deputy Solicitor General

JERROLD J. GANZFRIED
Assistant to the Solicitor General

ABRAHAM D. SOFAER
Legal Adviser
Department of State

MICHAEL L. PAUP
DAVID ENGLISH CARMACK
Attorneys

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1986

PAUL H. COPLIN and PATRICIA COPLIN,
Petitioners,
v.
UNITED STATES OF AMERICA

ROBERT E. O'CONNOR and GLADYS E. O'CONNOR,
Petitioners,
v.
UNITED STATES OF AMERICA

JACK R. MATTOX and MARIA MATTOX,
Petitioners,
v.
UNITED STATES OF AMERICA

On Writ of Certiorari to the United States Court of Appeals for the Federal Circuit

REPLY BRIEF FOR THE PETITIONERS

CARTER G. PHILLIPS
SIDLEY & AUSTIN
1722 Eye Street, N.W.
Washington, D.C. 20006
(202) 429-4000
Counsel for Petitioners

JOHN C. MORRISON
(Counsel of Record)
200 N. Fairfax Street
Alexandria, Virginia 22314
(202) 347-6000
Counsel for the Mattox Petitioners

ANDREW C. BARNARD
(Counsel of Record)
9769 South Dixie Highway
Suite 201
Miami, Florida 33156
(305) 665-0000

DAVID J. KIYONAGA
136 E. Bay Street
Suite 304
Jacksonville, Florida 32202
(904) 354-4042
Counsel for the Coplin Petitioners

ALLAN I. MENDELSOHN
(Counsel of Record)
MARVIN I. SZYMKOWICZ
WARD & MENDELSOHN, P.C.
1100 17th Street, N.W.
Suite 900
Washington, D.C. 20036
(202) 785-0200
Counsel for the O'Connor Petitioners

WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

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IN THE

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OCTOBER TERM, 1986

No. 85-558

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v.

UNITED STATES OF AMERICA

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JACK R. MATTOX and MARIA MATTOX,
Petitioners,

v.

UNITED STATES OF AMERICA

On Writ of Certiorari to the United States Court of Appeals for the Federal Circuit

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REPLY BRIEF FOR THE PETITIONERS

In their opening briefs petitioners put forward a substantial number of arguments in support of their claim that Article XV of the Agreement in Implementation of Article III of the Panama Canal Treaty, September 7, 1977, T.I.A.S. No. 10030, exempts employees of the Panama Canal Commission from United States income taxes for work performed for the Commission in Panama. The

government's response warrants a brief reply. Because the structures of the separate opening briefs were somewhat different, petitioners' consolidated reply will basically follow the organization employed by Chief Judge Kozinski in his *Coplin* opinion, and the brief will reply to the government's arguments as they relate to the various findings and holdings that led the Claims Court correctly to decide for the petitioners.

A. Obviously, the single most important reason for the Claims Court's holding that Article XV exempts petitioners from United States income taxes in their work for the Panama Canal Commission is the plain language of the provision. The relevant Article is entitled simply "Taxation," and the relevant paragraph within the Article describes the scope of the exemption as including "any taxes," which on its face includes United States taxes. Indeed, if the contracting governments intended, as petitioners submit they did, to exempt petitioners from both Panamanian and United States taxes, it is difficult to imagine what other language could more plainly evince that intent. Although this plain language does not end the inquiry under traditional rules of treaty interpretation, it places upon the government a heavy burden to demonstrate that petitioners' interpretation "effects a result inconsistent with the intent or expectations of its signatories." *Maximov* v. *United States*, 373 U.S. 49, 54 (1963).

To satisfy its burden, the United States argues (U.S. Br. 20-22) that when read "in context," the "any taxes" language cannot reasonably be understood to embrace United States taxes. The government's reasoning on this issue is self-defeating. It points out that both paragraphs 1 and 3 of Article XV relate only to Panamanian taxes and from this the government concludes that paragraph 2 should be similarly limited. But the government inexplicably ignores the fact that paragraphs 1 and 3 also include specific references to *Panama*. Thus, the plain

language of these provisions, read in context, expressly limits their reach to Panamanian taxes. The absence of any similar limiting language anywhere in paragraph 2 creates a strong inference, in support of the plain language, that the scope of the tax exemption *is not limited to Panama.*

What makes the inference even stronger is that the language in Article XVI of the Status of Forces Agreement ("SOFA") in implementation of Article IV of the Panama Canal Treaty concerning military personnel, which served as the model for Article XV (U.S. Br. 19 n. 11), contains a specific reference to Panamanian law. That reference was deleted by the United States drafters, making Article XV on its face apply to "all taxes" without any limitation. Thus, understood *in context*, the language in Article XV exempts petitioners from all taxes for income received from the Commission.

The United States' explanation for the deletion is strikingly weak. It asserts (U.S. Br. 25 n.16) that petitioners' reliance upon the removal of the "Panamanian law" reference in Article XV is unsupported by "the record." But the brief cites *nothing* in the record to justify removal of the phrase. Instead, the government asserts, without support, that the doctoring of the provision was done to eliminate any problem in the event Panama changed its tax laws. But the government does not explain why this identical language would still be kept in Article XVI of the SOFA Agreement and removed from Article XV if the sole basis for the action was to respond to potential problems in Panamanian law. Thus, the more rational explanation for the disparate language is that the plain meaning of Article XV which exempts all taxes was intended by the parties.

The United States argues that the relevant sentence exempting United States taxes for work for the Commission must be amended judicially because petitioners' plain meaning interpretation "would give credence" to an

argument that all income "derived from sources outside . . . Panama" is also exempt under the Treaty. U.S. Br. 16. But that interpretation is not compelled by the language in the second sentence. In order to give meaning to the word "similarly" in the second sentence, it is perfectly reasonable to interpret the word "income" to mean "income received as a result of [Commission employees'] work for the Commission" which is "derived from sources outside of the Republic of Panama." This would mean that the cumulative effect of paragraph 2 would be that all income relating to Commission activities, from whatever source, would be exempt from both countries' taxing powers, but that each could tax non-Commission-related income under their domestic laws.

B. After finding that the plain meaning of the first sentence of Article XV, read in context, plainly provided a tax exemption, the Claims Court analyzed the negotiating history to determine whether there was clear proof that the signatories reached an understanding about the provision that departed from its clear language. As the Claims Court held: "there is *no* contemporaneous evidence as to the meaning either [party] placed on the language of Article XV. . . ." 6 Cl. Ct. 126 (emphasis in original). Obviously, then, there is no basis for relying upon the negotiating history to amend the language agreed to by the parties.

The government nevertheless selectively analyzes (U.S. Br. 25-27) the negotiating history and concludes that "nothing in the negotiating history suggests that anything other than the question of exemption from Panamanian taxation was ever considered." *Id.* at 27. To be sure, Panama's primary concern was to exercise its sovereignty over the Canal by being able to tax all employees there. It did, however, expressly propose that the United States grant Commission employees a tax credit so that the United States, in effect, would be taxing the employ-

ees, but giving some of the money to Panama. C.A. App. 117. Thus, contrary to the government's assertion, the negotiating history contains a Panamanian proposal to modify domestic United States' taxation in order to give effect to Panama's sovereignty over the Canal.

This discussion in the weeks leading up to the final draft proposal of Article XV by the United States significantly colors the effect that the government's proposal had on the Panamanian negotiators.[1] Instead of sovereignty concerns being dealt with by both parties retaining the right to tax, the United States proposed to solve the problem by allowing *neither party* to tax that income.[2]

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[1] The government's claim that the "record clearly indicates that August was not the first time that Panama had seen the text of Article XV" ignores the record and the Claims Court's contrary findings. The Court found that "the language that eventually became Article XV of the Implementation Agreement was not considered during any of the sessions for which we have a transcript or other contemporaneous documentation," which includes all of the sessions up to and including July 21. 6 Cl. Ct. at 131. The "record" the government relies upon for its contrary view is an answer to an interrogatory which merely indicates that the internal draft of Article XV dated July 13 was "the proposal presented to the Panamanian negotiators." C.A. App. 26. The answer does not indicate *when* that draft was presented to the Panamanians. Nor could it have; its author was not present at the negotiating sessions. Thus, the only available evidence indicates that the United States' proposal was made in August and accepted on the basis of the careful language employed by the United States which exempted "any taxes" and deleted the reference to Panama. The timing of the proposal undercuts the government's assertion that Panama accepted this proposal because it "reflect[ed] the United States' position." U.S. Br. 28.

[2] The government belittles as the product of "surmise and conjecture" the Claims Court's interpretation of the negotiating history as indicating that the parties reached a compromise on the sovereignty issue. But the government's alternative theory that "Panama accepted the text drafted by the United States to reflect the United States' position" is based on pure speculation. U.S. Br. 28. The Court's theory at least is consistent with the negotiating history. The United States cannot explain why Panama would

This interpretation is fully consistent with the United States' position that it could not tolerate Panamanian taxation of United States employees. Thus, the negotiating history supports petitioners' interpretation of the meaning of the Article. In any event, there is no explicit statement of understanding by both sides at the negotiating table indicating that paragraph 2 of Article XV applied *only* to Panamanian taxes, and therefore, the negotiating history does not satisfy the standards in *Maximov* for disregarding the plain language of the Treaty.[3]

C. After the Claims Court held that the language and history of Article XV, as agreed to at the bargaining table, provided a tax exemption to petitioners, the Claims Court considered whether any action by the parties subsequent to the agreement clearly demonstrated that they

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suddenly abandon its interest without any discussion on this issue about which it is undisputed the parties had previously been "widely divergent." 6 Cl. Ct. at 129.

[3] The government's ultimate response to the Claims Court's finding that the language of Article XV was the product of a compromise over the sovereignty issue is that the government would never enter into such an agreement because Congress and the Executive Branch generally disapprove of such arrangements. In the same breath, the government concedes that "the United States has negotiated a few treaties with tax-sparing provisions." U.S. Br. 38 n.24. There is thus nothing sufficiently unusual in the Claims Court's interpretation that would justify ignoring the plain language employed by the treaty signatories.

Moreover, even if the Agreement provided unique treatment for Canal Commission employees, that would not be unusual. Those employees have been treated differently by the United States in a host of different ways. For instance, Commission employees have no access to PX or Commissary services, are not paid out of the United States Treasury, have a separate leave system, and are provided a "tropical differential" in their salary. Indeed, prior to 1954, employees of the Commission, in effect, did not pay United States income taxes. Thus, the Agreement is fully in keeping with Congress' past practices toward Commission employees.

actually intended the provision to have the meaning now ascribed to it by the United States in its pursuit of additional tax dollars. The Claims Court held that no post-agreement, pre-litigation materials were sufficient to overcome the plain meaning doctrine in interpreting Article XV.

The government emphasizes heavily (U.S. Br. 29-32) the legislative history of the Senate ratification process. Oddly, the government cites not a single case from this or any other court concerning what role this legislative history should play in determining the meaning of Article XV. Ordinarily, internal deliberations of *one* of the signatories to an international agreement is not relevant to interpreting that agreement, because the Court must determine what *both* parties understood the agreement to mean. *Fourteen Diamond Rings*, 183 U.S. 176, 180 (1901); Restatement (Second), Foreign Relations Law of the United States § 147 (1965). Nevertheless, the legislative history is almost as silent as the negotiating history on the critical issue of whether Article XV's exemption is limited to Panamanian taxes. The section-by-section analysis, quoted by the United States (U.S. Br. 31), clearly states that Article XV exempts Commission employees from Panamanian taxes, but does *not* state that the exemption is *limited* to Panamanian taxes. S. Exec. Rep. 95-12, 95th Cong., 2d Sess. 155 (1978). Given the importance to the government, as reflected in the internal documents created during the negotiating process (See C.A. App. 152, 154, 162), of exempting United States employees from Panamanian taxes, the State Department's decision to emphasize this point is understandable. State was concerned that if Panama could tax employees of an agency of the United States, opponents of the Treaty would try to use that fact to defeat its ratification. C.A. App. 162. The Senate Report thus clarifies one issue but does nothing to clarify the issue presented here—the effect of Article XV on

United States' taxes. The section-by-section analysis is silent on that issue.[4]

The government places particular emphasis upon the exchange during the Hearings between Herbert J. Hansell, Legal Advisor of the State Department, and Senator Stone. But that exchange does not warrant amending the Agreement judicially. In the first place, the government cites no case, and we are aware of none, in which this Court has relied upon a single statement made during a hearing as the sole basis to justify ignoring the plain meaning of a statute, much less a treaty. See *McCaughn* v. *Hershey Chocolate Co.*, 283 U.S. 488, 493 (1931); *March* v. *United States*, 506 F.2d 1306, 1314 n.30 (D.C. Cir. 1974). Second, what is truly meaningful from the exchange is the contrast between the clarity of Hansell's statement at the hearings compared to the statement in the Senate Report. The latter, which could serve as a legitimate basis for inferring the Senate's understanding of Article XV, is silent with respect to United States taxes. Third, the exchange is ambiguous. Hansell's promise was to find some way, short of using an understanding, to resolve the problem identified by Senator Stone. The United States reasons that because the Senate did not seek a reservation or understanding on Article XV, the Senate must have agreed with Hansell's statement. An equally plausible explanation for Senate inaction is that the Senate was satisfied

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[4] Even if the Court were interpreting an ordinary statute of Congress, instead of a provision in a Treaty's implementing agreement, the statement in the Senate Report would not suffice to warrant ignoring plain language in the statute as enacted. It is well settled that statements of legislators and other legislative materials should not be used to construe a statute contrary to its plain terms. *See Consumer Product Safety Commission* v. *GTE Sylvania, Inc.*, 447 U.S. 102, 108 (1980); *Southeastern Community College* v. *Davis*, 442 U.S. 397, 405 (1979). "Such aids are only admissible to solve doubt and not to create it." *Railroad Commission of Wisconsin* v. *Chicago, B. & Q.R.R.*, 257 U.S. 563, 589 (1922).

with the exemption embodied in the plain meaning of the Agreement. Alternatively, Hansell's promise to resolve the matter without using an understanding would fully explain why the Senate did not act independently. It may have relied upon Hansell's representation that the matter could be resolved without recourse to that particular diplomatic channel. The Senate's reliance was misplaced, but that provides no basis for this Court to disregard the language in the Agreement.[5]

D. Even though the Claims Court held that the government's interpretation of Article XV was unsupported by the language of the Agreement, the negotiating history leading up to the Agreement and events prior to its ratification, the Court nevertheless carefully considered and rejected the government's claim that the Executive Branch's interpretation of this international agreement is entitled to "great deference." 6 Cl. Ct. 135-143. The government strongly renews its argument here and asks that its self-serving interpretation of Article XV be upheld, regardless of all other considerations.[6] What the United

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[5] The government's use of the legislative materials is completely misguided. It assumes that the petitioners must find evidence that the Senate expressly intended to exempt them from having to pay United States taxes on Commission based income. Because of the plain language of the Agreement, however, it is the *government's* burden to show that the Senate clearly understood the language as having the special meaning argued for by the government.

[6] The government argues (U.S. Br. 13) that deference to its interpretation is warranted even if the Court is convinced that this interpretation conflicts with the understanding of our treaty partner at the time of the Agreement. This is not the law. The cases cited for this extraordinary proposition do not support such a rule. In *Factor* v. *Laubenheimer*, 290 U.S. 276, 298 (1933); *Charlton* v. *Kelly*, 229 U.S. 447, 473 (1913); and *Whitney* v. *Robertson*, 124 U.S. 190, 194-195 (1888), cited by the government (U.S. Br. 13), the Court did not hold that the Executive Branch's interpretation must be respected, even if it is contrary to the contemporaneous understanding of a treaty partner. The Court decided the very different issue of whether it should disregard a treaty obligation

States does not discuss are the reasons why the Court defers to the Executive Branch on such issues and whether those reasons apply in this case. Obviously, if they do not, then the Court should not defer to the government's proposed interpretation because in no event are the views of the Executive Branch conclusive upon the Court; "courts interpret treaties for themselves." *Kolovrat* v. *Oregon*, 366 U.S. 187, 194 (1961); *Sumitomo Shoji America, Inc.* v. *Avagliano*, 457 U.S. 176, 184 (1982).[7]

The Claims Court correctly identified the reasons for deferring to the federal government's interpretation of an international agreement—1) the Executive Branch has negotiated the Treaty and therefore may have unique insights into the parties' state of mind; 2) the Executive Branch is responsible for conducting foreign affairs and the Court's interpretation of a Treaty could interfere with those relations; 3) the Executive Branch administers the treaty and therefore may have expertise derived from experience with the treaty which could assist the Court. Restatement (Second), Foreign Relations Law of the United States, § 147(1)(c), (f), (h).

The government in its brief makes absolutely no attempt to show that *any* of these factors applies here. First, it has always been conceded that the State Department has no contemporaneous evidence concerning the

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assumed by the United States because the other signatory refused to abide by the provision. Those cases do not support the government's claim of slavish judicial deference to the Executive Branch's interpretation. Indeed, the government's claim would effectively nullify the rule that the interpretation of the Executive Branch is "not conclusive" on the Court. *Charlton* v. *Kelly*, 229 U.S. at 468.

[7] In *Sumitomo*, this Court made clear that the extent of the deference due to the Executive's interpretation depends greatly on whether "that interpretation follows from the clear treaty language. . . ." 457 U.S. at 185. Where, as here, the Executive's interpretation clearly serves selfish financial interests, and it conflicts with the language of the Agreement, the Executive's interpretation should be rejected.

negotiations leading up to the August session during which Article XV was finally proposed. Second, the government has never indicated that Panama or any other nation would be concerned at all if the Agreement were interpreted in accordance with its plain meaning.[8] Finally, there have been no "subsequent practices of the parties in the performance of the agreement" concerning Article XV that could serve as the basis for the Executive Branch's interpretation. Restatement (Second), Foreign Relations Law of the United States, § 147(1)(f). To the contrary, the agency charged with administration of the Treaty, the Panama Canal Commission's Supervisory Board, clearly indicated through its Panamanian members that it understood the Agreement to provide a tax exemption for United States' citizen employees. See O'Connor Br. 40-41. The government ignores these statements, but, if deference is owed to anyone, it is to the Board, and its understanding of the Agreement contrasts sharply with that of the Executive Branch. Thus, the government's argument amounts to no more than a request for deference for the sake of deference. This is no basis for rejecting the plain meaning of an international agreement.

E. The one item that the Claims Court could not evaluate was the diplomatic note mysteriously obtained from Panama on February 22, 1985, and filed with the Federal Circuit on the eve of oral argument. Not only was no diplomatic note produced in the Claims Court, but counsel for the government *repeatedly* represented to the Court that 1) no diplomatic note could be obtained; 2) any note the State Department might obtain would be irrelevant to this case; and 3) the government wanted the case to be decided solely on the record before the Claims Court as of March 8, 1984. 6 Cl. Ct. at 147.

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[8] We analyze the post-litigation, diplomatic note in the next section, but it is worth mentioning here that nothing in that document expresses any concern about U.S.-Panama relations if the Agreement is interpreted to exempt all taxes.

The government's desperate use on appeal of the diplomatic note in light of the statements made to the Claims Court is the best evidence of the manifest weakness in the government's interpretation of Article XV under the ordinary rules of treaty construction. Given the suspect circumstances surrounding the production of this note, which are discussed in petitioners' opening briefs (Coplin Br. 30-31; O'Connor Br. 14-17), the government's decision to rely upon it could only be justified by a strongly felt sense of need to rehabilitate its case on appeal. In light of the strength of the Claims Court's opinion, the government's concern was well founded. But the desire to win a case does not justify the government's blatant disregard for the ordinary judicial process.

In this Court, the government asserts, at the end of its summary of the traditional methods of interpreting international agreements, that "[i]n any event, the Government of Panama has now provided the United States with its official interpretation of the relevant provision," (U.S. Br. 9),[9] and therefore, the Court need not concern itself with the flaws in the government's case.

Petitioners submit that the diplomatic note is entitled to little or no weight under traditional rules of treaty interpretation. Alternatively, the Court certainly should not permit the government, after its representations to the Claims Court, to benefit from the note in these cases. The Court should not accept the note at face value as the Federal Circuit did. Certainly the Court should not affirm without allowing a factual inquiry into the circumstances surrounding the government's complete reversal of position and its acquisition of the diplomatic note. To

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[9] Given the government's unwillingness to reveal the circumstances surrounding the acquisition of the note, there is no small irony in the fact that the reference to "its" in the quotation from the government's brief could quite reasonably be read to refer to the "United States."

hold otherwise would violate fundamental notions of fair play that underlie the adversary process.

1. The Restatement (Second) on Foreign Relations Law contains a list of nine factors to be considered in interpreting any treaty. This list does not include a non-contemporaneous diplomatic note created and produced during the course of litigation. Restatement (Second) § 147(a)(i). Although the list was not intended to be exhaustive, the American Law Institute's reason for excluding a note like that from Panama is obvious. Such a *post hoc* recital is largely useless if not misleading, in attempting to understand the intent of the parties to an agreement reached many years before.[10] Thus, as an interpretative aid, this note is no more authoritative than a statement of a subsequent Congress about a law previously enacted, which is accorded little or no weight in interpreting the earlier legislation. *United States* v. *Southwestern Cable Co.*, 392 U.S. 157, 170 (1968); *Rainwater* v. *United States*, 356 U.S. 590, 593 (1958).

The government argues that this Court's decision in *Sumitomo* clearly supports reliance on the Panamanian note. The note in *Sumitomo* was very different; it did no more than indicate Japan's agreement with the pre-existing interpretation of this government and it was based on extremely unambiguous language. Indeed, even though the parties to the treaty in *Sumitomo* agreed on an interpretation that "follow[ed] from the clear treaty language," this Court did not end its inquiry there. 457 U.S. at 185. In sharp contrast to that case, the government here asks the Court to disregard the plain meaning of the Agreement in light of a diplomatic note, created

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[10] Cf. Fed. R. Evid. 803(6), 804(8); *Palmer* v. *Hoffman*, 318 U.S. 109, 114 (1943) (rejecting certain business records "calculated for use essentially in the court, not in the business"). What the Court said in *Palmer* about the railroad's report can be applied directly to the unpublished diplomatic note: "its primary utility is in litigating," not in diplomacy. *Id.*

for no reason except to further this government's interest as a *litigant*. This plainly is not *Sumitomo*.

Moreover, the rule proposed by the government is extremely shortsighted. Under this theory, any change in the administration of either government provides a complete opportunity to rework any international agreement without having to go through the treaty-making process. Thus, no agreement has any set shelf life. Such a rule will clearly have an adverse effect on the willingness of other nations to enter into bilateral agreements with this government.

Under the government's theory, the Senate's understanding of a treaty can always be rejected by a new administration if it can convince a treaty partner to supply a diplomatic note. This demeans the Senate's ratification power and conflicts with the basic notion that "[a] treaty, then, must be a *bona fide* agreement between states, not a 'mock marriage,' nor a unilateral act by the United States to which a foreign government lends itself *as an accommodation* . . . .". L. Henkin, Foreign Affairs and the Constitution 143 (1972) (emphasis added). In order to accord proper respect for the treaty-making process, the Court should reject the use of diplomatic notes unless: 1) they are produced as part of the ordinary process of administering an international agreement, as opposed to being used solely in anticipation of use in litigation, Restatement (Second), Foreign Relations Law § 147 (referring to the performance under the treaty); or 2) unless, as in *Sumitomo*, the note merely reinforces the conclusion compelled by all other available interpretative factors concerning the treaty. Under these standards, the note in this case should not be given the dispositive weight requested by the United States.

2. If, however, the Court in the abstract would be willing to give some weight to Panama's diplomatic note, it is clear that in this case the government should be bound by its representations to the Claims Court that no note would

be forthcoming and that, even if such a note existed, it would not be relevant. The government's response to petitioners' argument that its litigating tactics were grossly unfair is deeply disturbing. First, it argues that technically this is not an appropriate case for judicial estoppel because the government is not taking inconsistent positions in separate lawsuits. U.S. Br. 43 n. 26. This is hardly a defense; it is, if anything, worse for the government to take an absolutely inconsistent position *in the same case on appeal* and thereby to render the trial court proceeding meaningless. Second, the government argues that it has been consistent in this litigation because all along it has wanted to win this case. But, a uniform desire to win does not justify the government's decision to reject the need for a note in the trial court and yet rely upon the note on appeal. Finally, the government offers its most cynical argument—this Court should "not blind itself" to the valuable information in this diplomatic note. Instead the government asks the Court to "blind" itself to the unfairness inherent in the government's action and the affront to the Claims Court. If the Court must choose, it should disregard the note in order to remedy the government's attempt to render the trial court proceedings a nullity.

3. At a minimum, the Court should not accept the diplomatic note at face value and rely upon it to interpret Article XV in a manner that conflicts with its plain meaning. Obviously, petitioners strongly believe that the Court should reverse the judgment of the court of appeals on the basis of the plain meaning of the Agreement, but if the Court is unpersuaded, it should not simply affirm. The Claims Court should be given an opportunity to inquire into why the United States government shifted its position on appeal.[11] Certainly, peti-

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[11] Petitioners recognize and are sensitive to the unusual inquiry called for on remand. An inquiry into diplomatic efforts and motivations should be permitted only in extraordinary circumstances.

tioners' claim would be significantly enhanced if the representations made to the Claims Court reflected unsuccessful efforts by the State Department to obtain similar notes in the past from the Panamanian government which had negotiated and signed the treaty. This would be strong evidence that the Claims Court was correct that Panama understood the Agreement to embody a compromise at the time it was signed. The only way to determine that issue, however, is to remand the matter for further discovery and a determination of whether the government has dealt fairly with the Claims Court and the petitioners in this case.

* * * *

The fundamental flaw in the government's submission to this Court is that it refuses to deal with the basic issue in this case: what did Panama and the United States agree to *in August 1977*. The government has gone to great lengths to demonstrate what the State Department, the new Panamanian regime and even the House of Representatives might prefer *today*, but it has made no serious challenge to the Claims Court's findings and holding concerning the expectations of the parties in light of the negotiations leading up to the final agreement and the language actually chosen in 1977.

The government's attempted sleight of hand must fail. Its *post hoc* "evidence of intent" created because of litigation provides no basis for this Court to rewrite the agreement in order to deprive petitioners of the third-party beneficiary rights which are contained in Article

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But, it is the government which has caused this problem by making very clear representations in the Claims Court and acting directly contrary to those statements on appeal. If the government would prefer to avoid the problem caused by its conduct, it could ask the Court again to decide the case on the record before the Claims Court. If, because of the weakness of its interpretation without the diplomatic note, the government prefers to have the note considered, then it should be prepared to submit its actions to judicial scrutiny.

XV. If Panama and the United States are now in agreement that Article XV is no longer warranted, there are methods available to effect that result. The course the government has chosen—asking this Court to amend the Agreement—is not one of them. The Court therefore should decline the government's invitation to substitute itself for the political branches of the governments of the United States and Panama and instead exercise solely its judicial function by enforcing the plain meaning of Article XV.

CONCLUSION

For the foregoing reasons and those stated in the opening briefs of the petitioners, the judgment of the court of appeals should be reversed.

Respectfully submitted,

CARTER G. PHILLIPS
SIDLEY & AUSTIN
1722 Eye Street, N.W.
Washington, D.C. 20006
(202) 429-4000
Counsel for Petitioners

JOHN C. MORRISON
(Counsel of Record)
200 N. Fairfax Street
Alexandria, Virginia 22314
(202) 347-6000
Counsel for the Mattox Petitioners

ANDREW C. BARNARD
(Counsel of Record)
9769 South Dixie Highway
Suite 201
Miami, Florida 33156
(305) 665-0000

DAVID J. KIYONAGA
136 E. Bay Street
Suite 304
Jacksonville, Florida 32202
(904) 354-4042
Counsel for the Coplin Petitioners

ALLAN I. MENDELSOHN
(Counsel of Record)
MARVIN I. SZYMKOWICZ
WARD & MENDELSOHN, P.C.
1100 17th Street, N.W.
Suite 900
Washington, D.C. 20036
(202) 785-0200
Counsel for the O'Connor Petitioners

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1986

ROBERT E. O'CONNOR and GLADYS E. O'CONNOR,
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v.
UNITED STATES OF AMERICA

PAUL H. COPLIN and PATRICIA COPLIN,
Petitioners,
v.
UNITED STATES OF AMERICA

JACK R. MATTOX and MARIA MATTOX,
Petitioners,
v.
UNITED STATES OF AMERICA

On Writ of Certiorari to the United States Court of Appeals for the Federal Circuit

MOTION FOR LEAVE TO FILE POST ARGUMENT A SUPPLEMENTAL BRIEF FOR THE PETITIONERS AND SUPPLEMENTAL BRIEF FOR THE PETITIONERS

CARTER G. PHILLIPS
SIDLEY & AUSTIN
1722 Eye Street, N.W.
Washington, D.C. 20006
(202) 429-4000
Counsel for Petitioners

JOHN C. MORRISON
(Counsel of Record)
200 N. Fairfax Street
Alexandria, Virginia 22314
(202) 347-6000
Counsel for the Mattox Petitioners

ANDREW C. BARNARD
(Counsel of Record)
9769 South Dixie Highway
Suite 201
Miami, Florida 33156
(305) 665-0000

DAVID J. KIYONAGA
136 E. Bay Street
Suite 304
Jacksonville, Florida 32202
(904) 354-4042
Counsel for the Coplin Petitioners

[Counsel continued on inside cover]

WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

ALLAN I. MENDELSOHN
(Counsel of Record)
MARVIN I. SZYMKOWICZ
WARD & MENDELSOHN, P.C.
1100 17th Street, N.W.
Suite 900
Washington, D.C. 20036
(202) 785-0200
Counsel for the
O'Connor Petitioners

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On Writ of Certiorari to the United States Court of Appeals for the Federal Circuit

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MOTION FOR LEAVE TO FILE POST ARGUMENT A SUPPLEMENTAL BRIEF FOR THE PETITIONERS

Pursuant to Rule 35.5 of the Rules of this Court, petitioners move for leave to file after argument the accompanying brief to apprise the Court of the final enactment of the Tax Reform Act of 1986, Pub. L. No. 99-514, and "to analyze and argue as to the impact of" Section 1232(a) of the Act "on the questions pending before the Court." R. Stern, E. Gressman & S. Shapiro, Supreme Court Practice 575 (6th ed. 1986). See *Public Service Comm'n* v. *Mid-Louisiana Gas Co.*, 463 U.S. 319 (1983); *Arizona* v. *San Carlos Apache Tribe*, 463 U.S. 545 (1983).

On October 22, 1986, President Reagan signed into law the Tax Reform Act, which contains a provision relevant to this case. Section 1232(a) provides:

> "Nothing in the Panama Canal Treaty (or in any agreement implementing such Treaty) shall be construed as exempting (in whole or in part) any citizen or resident of the United States from any tax under the Internal Revenue Code of 1954 or 1986. The preceding sentence shall apply to all taxable years whether beginning before, on, or after the date of the enactment of this Act (or in the case of any tax not imposed with respect to a taxable year, to taxable events after the date of enactment of this Act)."

Obviously, the provision is intended to eliminate the claim of petitioners, and others like them, that Article XV of the Agreement in Implementation of Article III of the Panama Canal Treaty, September 7, 1977, T.I.A.S. No. 10030, exempts U.S. employees of the Panama Canal Commission from U.S. taxes on Commission-related work. Because the statute did not become effective until after the oral argument in this case,* petitioners have had no op-

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* When petitioners filed their Reply Brief, the Tax Reform Act in the main had passed both Houses of Congress. Because the bill was still subject to technical changes, it was not ready for the President's signature prior to the argument on October 14, 1986.

portunity to analyze for the Court the effect of the statute on the issues presented. Accordingly, petitioners submit that their motion for leave to file a post-argument supplemental brief should be granted.

Respectfully submitted,

CARTER G. PHILLIPS
SIDLEY & AUSTIN
1722 Eye Street, N.W.
Washington, D.C. 20006
(202) 429-4000
Counsel for Petitioners

JOHN C. MORRISON
(Counsel of Record)
200 N. Fairfax Street
Alexandria, Virginia 22314
(202) 347-6000
Counsel for the Mattox Petitioners

ANDREW C. BARNARD
(Counsel of Record)
9769 South Dixie Highway
Suite 201
Miami, Florida 33156
(305) 665-0000

DAVID J. KIYONAGA
136 E. Bay Street
Suite 304
Jacksonville, Florida 32202
(904) 354-4042
Counsel for the Coplin Petitioners

ALLAN I. MENDELSOHN
(Counsel of Record)
MARVIN I. SZYMKOWICZ
WARD & MENDELSOHN, P.C.
1100 17th Street, N.W.
Suite 900
Washington, D.C. 20036
(202) 785-0200
Counsel for the O'Connor Petitioners

October 29, 1986

Petitioners waited until it was clear that no new law would be in effect before filing their reply. Petitioners at that time decided it was unnecessary, and indeed, unwarranted to analyze the effect of a law that was not finalized. Accordingly, this is the first appropriate occasion for petitioners to discuss the relevance of Section 1232(a).

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1986

No. 85-558

ROBERT E. O'CONNOR and GLADYS E. O'CONNOR,
Petitioners,

v.

UNITED STATES OF AMERICA

No. 85-559

PAUL H. COPLIN and PATRICIA COPLIN,
Petitioners,

v.

UNITED STATES OF AMERICA

No. 85-560

JACK R. MATTOX and MARIA MATTOX,
Petitioners,

v.

UNITED STATES OF AMERICA

On Writ of Certiorari to the United States Court of Appeals for the Federal Circuit

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SUPPLEMENTAL BRIEF FOR THE PETITIONERS

On October 22, 1986, the President signed into law the Tax Reform Act of 1986. Pub. L. No. 99-514. Prior to the argument on October 14, 1986, the Solicitor General, with petitioners' consent, lodged copies of Section 1232(a) of the Tax Reform Act of 1986 as passed by Congress, which is relevant to this case.[1] Petitioners are filing this Supplemental Brief to discuss what, if any, effect, the new provision should have on the Court's disposition of this case.

1. The easiest and most appropriate course for the Court to follow would be to ignore the new provision for the purpose of deciding the questions presented in the petitions for writs of certiorari. The Court can, and should, decide what the United States and Panama intended in 1977 when they finally agreed upon the exact language in Article XV of the Agreement in Implementation of Article III of the Panama Canal Treaty. If the Court holds that the plain language, structure and negotiating history of the Agreement demonstrate that United States' citizen employees of the Panama Canal Commission were exempted from U.S. taxes, then it can remand the case to the Claims Court for a determination of what effect, if any, Section 1232(a) has on the outcome of these cases.[2] Moreover, the Claims Court would clearly

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[1] Section 1232(a) provides:

> "Nothing in the Panama Canal Treaty (or in any agreement implementing such Treaty) shall be construed as exempting (in whole or in part) any citizen or resident of the United States from any tax under the Internal Revenue Code of 1954 or 1986. The preceding sentence shall apply to all taxable years whether beginning before, on, or after the date of the enactment of this Act (or in the case of any tax not imposed with respect to a taxable year, to taxable events after the date of enactment of this Act)."

The Solicitor General also lodged copies of the portions of the House, Senate and Conference Reports relevant to Section 1232(a).

[2] If the Court holds that, contrary to the plain language of Article XV, the two nations only intended to exempt Panamanian

be a more appropriate forum for the parties to litigate due process claims petitioners would raise if the government would urge the Court to apply the provision retroactively. See page 6 *infra*.

At oral argument, the government's attorney discussed the relevant provision in the bill simply as an indication of what Congress now believes the Agreement provided. Of course, used in that way, the new statute is completely irrelevant. Statements of a subsequent Congress concerning the intent of previously enacted laws or treaties are entitled to no weight in interpreting the earlier law. See *United States* v. *Southwestern Cable Co.*, 392 U.S. 157, 170 (1968); *Rainwater* v. *United States*, 356 U.S. 590, 593 (1958).

It is, however, noteworthy that both the House and the Senate expressly acknowledged that the reading of the Agreement by the Eleventh Circuit in *Harris* v. *United States*, 768 F.2d 1240 (11th Cir. 1985), petition for cert. pending, No. 85-1011, which directly supports petitioners' interpretation, seemed to be consistent with the evidence before that court, which included everything before this Court except for the Panamanian Note. S. Rep. No. 99-313, 99th Cong., 2d Sess. 386 (1986); H.R. Rep. No. 99-426, 99th Cong., 1st Sess. 428 (1985). Thus, both Houses recognized the merit of the Eleventh Circuit's interpretation based on the language, structure and negotiating history of Article XV.

Congress, however, concluded that in light of the notorious diplomatic Note "Panama has confirmed the United States' explanation that the exemption was intended to apply solely to Panamanian taxes." S. Rep. No. 99-313, *supra* at 386; H.R. Rep. No. 99-426, *supra* at 427. But that Note, which the government refused to obtain or supply to the Claims Court, is entitled to no weight in

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taxes, then the Court would have no occasion to pass on the effect of Section 1232(a).

this litigation. *E.g.*, Pet. Reply Br. 11-16. Thus, Congress' construction of the Agreement, embodied in Section 1232(a), completely ignores the rules of interpretation that courts must follow.[3] Accordingly, as evidence of the meaning of the Agreement, Congress' recent action is simply beside the point.

2. If the Court feels obliged, because of the clear retroactive language used by Congress, to consider the effect of Section 1232(a) in this litigation, then it should declare the provision, literally read, to be an unconstitutional invasion by the legislative branch of powers reserved to the judiciary in the U.S. Const. Art. III.[4]

Article III vests all judicial power in this Court and all lower federal courts Congress chooses to create. Congress is invested with no judicial power and therefore can only restrict a federal court's power to exercise its judicial function by restricting its jurisdiction; Congress cannot dictate the outcome of specific cases. See *United States* v. *Klein*, 80 U.S. (8 Wall.) 128 (1871). Section 1232(a) purports to do *precisely* what this Court in *United States* v. *Klein* held was beyond Congress' legislative power. In *Klein*, this Court considered the effect of a congressional statute which declared "in substance that no pardon, . . . shall be admissible . . . to establish the right of any claimant to bring suit in that court; nor, if already put in evidence, shall be used or considered on behalf of the claimant, by said court, or by the appellate

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[3] The only other material cited by the Reports is some of the legislative history in the Senate during the Treaty ratification process, which petitioners have already shown is wholly inadequate as a basis for disregarding the plain meaning of an international agreement. Pet. Reply Br. 7-8.

[4] Article III, Section 1 provides in pertinent part:

"The judicial Power of the United States, shall be vested in one supreme Court, and in such inferior Courts as the Congress may from time to time ordain and establish.

court on appeal." *Id.* at 143. The Court struck down the law as applied and held that Congress could not "prescribe a rule for the decision of a cause in a particular way" without passing "the limit which separates the legislative from the judicial power." 80 U.S. at 146, 147. What made the statute particularly offensive was that it required the Court to decide the case before it in the government's favor. 80 U.S. at 147; *United States* v. *Sioux Nation of Indians*, 448 U.S. 371, 405 (1980).

This is exactly what Section 1232(a), if applied to this case, requires. The language of the statute could not be aimed more clearly at the judicial function; the Court is prohibited from "*constru[ing]*" the Agreement with Panama to provide any exemption from United States' taxes. Moreover, the legislative history plainly indicates that the Congress was fully aware of the on-going litigation. Indeed, the Senate expressly recognized "the litigation rights of persons under current law" and therefore proposed that Section 1232(a) be applied "only to future years." S. Rep. No. 99-313, *supra* at 387. Instead of disavowing the Agreement prospectively, which the Senate tried to do, Congress has attempted to dictate the outcome of this case and has done so to insure that the government wins this case and all others pending on this issue in the lower federal courts. Under *Klein*, this clearly violates Article III.[5]

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[5] Whether the constitutionally suspect sentence retroactively applying the provision should be severed from the first, which merely declares how the Agreement should be construed, depends upon Congress' intent. *See, e.g., Carter* v. *Carter Coal Co.*, 298 U.S. 238, 316 (1936). There is no evidence that Congress intended actually to abrogate the Agreement if it was misinterpreting it. Instead, the provision was described by both Houses as a "clarification." H.R. Rep. No. 99-426, *supra* at 428; S. Rep. No. 99-313, *supra* at 387.

Also, Congress has a much stronger financial interest in eliminating the exemption retroactively. Since 1979, the number of U.S. citizen employees has steadily dropped (a total reduction of 44.1%); no new U.S. citizens are being hired permanently and the remain-

3. Alternatively, Congress' attempt retroactively to abolish petitioners' rights created by an agreement with another country raises a serious due process issue. Clearly, under petitioners' interpretation of Article XV, Panama and the United States compromised and conferred upon petitioners and other U.S. employees of the Commission a bi-national exemption against income taxes for Commission-related work. While legislative action is presumed not to create contractual rights, the presumption is rebuttable. *Wisconsin & Mich. Ry. Co.* v. *Powers*, 191 U.S. 379, 386 (1903). There is certainly a serious question whether Congress can extinguish petitioners' rights under the Agreement, which are akin to the rights of a third party beneficiary to a contract, without a better reason than the government's unilateral desire to increase revenues. Unlike the Article III issue, however, the due process problem is a complicated one that would require additional factual development. Accordingly, the due process issue would necessarily require a remand to allow the Claims Court to evaluate fully, and in the first instance, the nature of petitioners' interests and the requirements of the Due Process Clause.

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ing U.S. citizens face certain termination from employment by the end of the century under the mandate of the Treaty. It therefore seems unlikely that Congress would add to the burden of these employees if it cannot eliminate the exemption retroactively.

CONCLUSION

For the reasons stated herein, the Court should decide these cases on the basis of Article XV of the Agreement in Implementation of Article III of the Panama Canal Treaty without regard to the recently enacted Section 1232(a) of the Tax Reform Act of 1986.

Respectfully submitted,

CARTER G. PHILLIPS
SIDLEY & AUSTIN
1722 Eye Street, N.W.
Washington, D.C. 20006
(202) 429-4000
Counsel for Petitioners

JOHN C. MORRISON
(Counsel of Record)
200 N. Fairfax Street
Alexandria, Virginia 22314
(202) 347-6000
Counsel for the Mattox Petitioners

ANDREW C. BARNARD
(Counsel of Record)
9769 South Dixie Highway
Suite 201
Miami, Florida 33156
(305) 665-0000

DAVID J. KIYONAGA
136 E. Bay Street
Suite 304
Jacksonville, Florida 32202
(904) 354-4042
Counsel for the Coplin Petitioners

ALLAN I. MENDELSOHN
(Counsel of Record)
MARVIN I. SZYMKOWICZ
WARD & MENDELSOHN, P.C.
1100 17th Street, N.W.
Suite 900
Washington, D.C. 20036
(202) 785-0200
Counsel for the O'Connor Petitioners

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